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No. 16,014

IN THE
United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

VS.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,

Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

BRIEF FOR THE APPELLANT.

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No. 16,014

IN THE

**United States Court of Appeals
For the Ninth Circuit**

UNITED STATES OF AMERICA,
Appellant,

vs.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,
Appellee.

**On Appeal from the Judgment of the United States District Court
for the Northern District of California.**

BRIEF FOR THE APPELLANT.

OPINION BELOW.

The opinion of the District Court (R. 34-49) is reported at 158 F. Supp. 25.

JURISDICTION.

This appeal involves federal estate taxes. The taxes in dispute plus interest in the total amount of \$222,357.11 were paid on or about August 24, 1954. (R. 55.) Claim for refund was filed on or about

March 10, 1955 (R. 15-19), and the Commissioner of Internal Revenue rejected the claim on March 21, 1956 (R. 8, 10, 21, 23). Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on July 3, 1956, the taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 3-19.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment was entered on March 17, 1958. (R. 56-57.) Within sixty days and on May 2, 1958, a notice of appeal was filed. (R. 58.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED.

1. Whether the court below erred in holding that no part of the value of insurance held in the name of decedent's husband was includible in her gross estate where such insurance was community property of the decedent and her husband.

2. Whether the court below erred in holding five annuity policies held by the wife in her own name to be community property, only one-half of which was includible in her gross estate, in view of the statutory presumption that personal property acquired by a married woman by an instrument in writing is her separate property and also in view of the fact that the husband had knowledge of all and specifically acquiesced in three written requests that he be replaced by someone else as primary beneficiary of the policies.

STATUTES INVOLVED.

These appear in Appendix A, *infra*.

STATEMENT.

This is an action brought by the executor of the estate of Mary W. Stewart to recover federal estate taxes. The case was tried entirely on the pleadings and a written stipulation of facts. (R. 34.)

Ashby and Mary Stewart were married in 1906 and their marital relationship continued until Mary's death on February 21, 1951. At all times pertinent to this case they were residents of California. This action concerns the includibility in Mrs. Stewart's estate of various insurance and annuity policies. (R. 25, 34-35.)

There were twenty-six insurance policies insuring the surviving husband, Mr. Stewart. (Ex. G.) Each of these policies was procured after the marriage of Mr. and Mrs. Stewart, and it is stipulated all premiums were paid with community property funds.¹ The policies therefore were community property. (R. 45.) They may be divided into three categories.

The first group consists of thirteen policies of twenty payment life insurance fully paid. (Exs. H, I, J, K and L.) The decedent is designated the pri-

¹There is no problem present concerning the includibility of pre-1927 community property. The amount which the Commissioner included in the return was one-half of the portion of the cash surrender value which was attributable to premiums paid out of post-1927 community property funds. (R. 9, 18, 23, 29-30; Ex. G.)

mary beneficiary in twelve of these policies and her daughter is primary beneficiary of the other. As to ten policies wherein decedent was primary beneficiary the husband subsequently changed the mode of settlement of the contract in the event of his death and named contingent beneficiaries should his wife not survive the receipt of all of the payments thereunder. These requests for change were endorsed by decedent. (Exs. H, I, K.) However, there is no indication of any similar endorsement by decedent on the other two policies in which she was named primary beneficiary (Exs. J, L), nor is there any such written concurrence in the naming of her daughter as primary beneficiary of one of the policies (Equitable, No. 2796071). In each policy in this group the husband retained the right to change beneficiaries.

The second group is comprised of eight twenty-year deferred annuity contracts. In each of these eight contracts decedent is designated the primary beneficiary. (Exs. M, N, O, P, Q.) Decedent endorsed change requests in connection with five of these policies. (Exs. M, O, P, Q.) There were no such endorsements in connection with the remaining three policies. (Exs. M, policy No. 9577482; N.) The husband had the right to change beneficiaries in only two of these policies. (Ex. M.)

The last group consists of five ordinary life insurance policies. (Exs. R, S, T.) The daughter was named primary beneficiary of three of the policies (Exs. R, S), one so designated the granddaughter (Aetna No. 778051) and the decedent was primary

beneficiary of the last policy (Ex. T). There is no record of written endorsements of any sort by decedent on either those policies naming her daughter or granddaughter as primary beneficiaries nor on that in which she was named primary beneficiary. The right to change beneficiaries was retained by the husband in each of these five policies.

The court below held that no part of the value of any of the above twenty-six policies was includible in decedent's gross estate (R. 55), and from this determination the United States here appeals (R. 63).

In 1934 and 1935 Mrs. Stewart was issued seven annuity policies and the premiums for each were paid with community funds. Each provided for the payment of monthly sums to her for life, beginning when she reached a designated age. These policies originally provided that in the event of her death prior to the payment of any annuities or before the amount paid in had been returned, payment was to be made to certain named beneficiaries. (Exs. B, C, D, E, F.) These policies may be separated into four groups: the Fidelity policies, the Hancock policies, the Equitable policy and the Aetna policies. (R. 36, 40.)

Fidelity policies. Originally, Mrs. Stewart designated her husband as the primary beneficiary and her daughter and grandchildren as the contingent beneficiaries. In 1948, at Mrs. Stewart's request, the insurance company eliminated her husband as the primary beneficiary and substituted her daughter. The grandchildren continued to be contingent beneficiaries. There was no consent or acknowledgment by Mr. Stew-

art to this change of beneficiary. In December, 1950, pursuant to an option given her in the policies, Mrs. Stewart elected to take payment of the total amount of the policies in 240 equal monthly installments in lieu of the annuity provisions contingent on her life. On Mrs. Stewart's death the balance of the payments not theretofore made to her was to be made to her daughter, and in the event of the daughter's death before all payments had been received, the grandchildren were to receive the balance of the payments. At about the same time as this election, Mr. Stewart signed a statement addressed to the insurance company in which he relinquished all his community rights in these policies. (R. 36-37.) The court below held that all of the proceeds of the Fidelity policies are includible in Mrs. Stewart's gross estate as her separate property (R. 44, 52-54), and this matter is no longer in controversy.

Hancock policies. Mr. Stewart was designated as the primary beneficiary at the time of issuance of these policies. In 1945 Mrs. Stewart changed the mode of settlement of the policies and Mr. Stewart joined in her request for this change by signing the form under which the change was requested. In 1948 Mrs. Stewart excluded her husband as the beneficiary and named her daughter as the primary beneficiary and her grandchildren as contingent beneficiaries. Mr. Stewart joined in this requested change in the same manner in which he joined in the 1945 change. A few months prior to Mrs. Stewart's death in 1951, she notified the company of her election to

take payment of a designated sum for 240 months certain and relinquished her right to take payments contingent on her life. Her daughter was to receive these payments in the event of Mrs. Stewart's death prior to the expiration of the 240 months, and payment was to be made to the grandchildren in the event the daughter did not survive this period. (R. 37-38.)

Equitable policy. Here, too, Mr. Stewart was the primary beneficiary at the time the policy was issued. In 1948 Mrs. Stewart eliminated her husband as primary beneficiary. Mr. Stewart joined in this request for a change of beneficiaries by signing his name beneath a line on the request form which read as follows: "I hereby agree to the foregoing beneficiary provisions. Signature of Annuitant's husband." In December, 1950, Mrs. Stewart exercised the option given to her in the policy to receive a designated monthly sum for 240 months in lieu of her right to receive an annuity contingent on her life. This change in the mode of settlement provided that if she died before receiving all of the 240 payments, her daughter was to be the recipient and if the daughter did not survive this period payment was to be made to the grandchildren. (R. 38-39.)

Aetna policies. Mr. Stewart was primary beneficiary, with the daughter and grandchildren contingent beneficiaries. In 1948 Mrs. Stewart excluded her husband as the primary beneficiary, and substituted her daughter therefor. There is no written acknowledgment or consent by Mr. Stewart to this change, however he did sign the request form on the line pro-

vided for the signature of "Witness." In November, 1950, Mrs. Stewart changed the mode of settlement. She elected to take 240 monthly payments of a sum certain in lieu of the contingent annuity provision. Her daughter was to receive the payments if Mrs. Stewart died before she received all of the 240 payments and the grandchildren took if the daughter did not survive this period. Both Mr. and Mrs. Stewart signed the form provided by the insurance company by which the request for this change was made. (R. 39.)

In all of the above mentioned policies, Mrs. Stewart alone was described as the person having the right to name or change the beneficiary. (R. 39.) The court below held that the Hancock, Equitable, and Aetna policies were assets of the community and that they were includible in Mrs. Stewart's gross estate only to the extent of one-half of their value. (R. 41, 51-52.) From this determination the United States here appeals. (R. 63.)

STATEMENT OF POINTS TO BE URGED.

1. The District Court erred in holding that no part of community property insurance held in the name of the husband was includible in decedent's gross estate.

2. The District Court erred in failing to hold that one-half of the cash surrender value of community property insurance held in the name of the husband was includible in decedent's gross estate.

3. The District Court erred in holding that the Hancock, Aetna and Equitable policies were community property of decedent and her husband and that only one-half of their value was includible in her gross estate.

4. The District Court erred in failing to hold that all of the policies held by decedent were her separate property and that their full value was includible in her gross estate.

SUMMARY OF ARGUMENT.

1. The District Court correctly held that the twenty-six insurance policies issued to the husband were community property, however it went on to hold that they were not includible in decedent's gross estate on the theory that her interest in these policies was no more than a "right of protection" which was extinguished upon her death. This is not an accurate statement of the California law. Where the premiums on insurance policies on the life of the husband are paid from community funds, as in this case, the policies themselves are community assets, as are the proceeds at the death of the insured. A surviving spouse has been held to take a one-half interest in the proceeds of such insurance, not as a beneficiary of the policy, but as an owner of a one-half interest therein. Here we are concerned only with new-type community property, acquired after July 29, 1927. On that date, Section 161a of the Civil Code of California was enacted. That section provides that the "interests of

the husband and wife in community property * * * are present, existing and equal interests." Thus, at the time of her death the decedent had a vested one-half ownership interest in the policies which could not be taken from her without her consent. The fact that the husband is by statute given the management and control of community property in no way diminishes the wife's vested interest in such property for it is expressly provided that he cannot make a gift of the property without the written consent of the wife. This limitation has frequently been held applicable to insurance policies. Thus, where the husband without his wife's consent has made a third party a beneficiary of his insurance the gift has been held a nullity as to the wife. There is not, in this case, any written consent by the decedent which would allow the husband to make a gift of any portion of these policies. She did not give up her community rights therein. Thus, the interest of the wife in the policies is much more substantial than a "right of protection" as the lower court erroneously held. She had a vested ownership interest of one-half of the policies, extending to a clear right of testamentary disposition of such interest under the California Probate Code. As such, the policies are includible in her gross estate under Section 811(a) of the Code to the extent of her ownership interest therein. Alternatively, if it can be held that the husband's action in obtaining the insurance had the effect of making a gift on the part of the wife, either to the husband or to the beneficiaries, half of the insurance is still includible in her estate. Since

she has a right to void such a gift, her interest is includible in her estate under either Section 811(c)(1)(C) (a transfer intended to take effect in possession or enjoyment after her death) or under Section 811(d) (a transfer the enjoyment of which was subject at the date of death to revocation by the decedent). One-half of the cash surrender value of these policies is includible in decedent's gross estate and the decision below to the contrary should be reversed.

2. Since Section 164 of the Civil Code of California provides that if any personal property is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property, the lower court erred in failing to hold that the annuities held by the wife in her name were the separate property of decedent wife. Such annuity interests were acquired by the decedent by an instrument in writing, and there has been no evidence whatever to rebut the presumption that they are separate property. The District Court likewise erred in failing to consider the cases holding that transfers by a husband of community property to his wife raise a prima facie presumption that he intended the transfer to be a gift. Therefore, despite the fact that the premiums on these policies were paid with community funds, they are presumptively the separate property of the wife. Alternatively, should it be held that these policies did not become the separate property of the wife at the time they were issued, it is apparent that when the husband gave his unqualified assent that he be replaced by someone else as primary beneficiary he

was giving up his community interest in the policies. At the time of such consents, therefore, the policies became the separate property of the wife. Since the policies were the separate property of the wife at the time of her death, they are includible in her estate to the extent of their full value and the decision of the lower court to the contrary should be reversed.

ARGUMENT.

I.

WHERE INSURANCE POLICIES HELD IN THE NAME OF THE SURVIVING HUSBAND ARE COMMUNITY PROPERTY, ONE-HALF OF THEIR VALUE IS INCLUDIBLE IN THE GROSS ESTATE OF DECEDENT WIFE.

The District Court held, and correctly so, that the twenty-six insurance policies held in the name of the surviving husband were community property. (R. 45.) These policies were all procured after the marriage of Mr. and Mrs. Stewart and all of the premiums thereon were paid with community funds.² This holding, however, did not in the opinion of the lower court compel a decision in favor of the Government's position that one-half of the cash surrender value of these policies is includible in the decedent wife's gross estate. Stating (R. 47) that "the law of the state does not provide the means by which the wife's executor can obtain possession or control of one-half of the cash surrender value of the policies," the court went on to hold that the wife's interest in the policies was

²See footnote 1, *supra*.

no more than a "right of protection" and that this right was extinguished upon her death (R. 48-49). This holding, it is submitted, is not an accurate statement of the California law of community property as it relates to insurance policies purchased with community funds. Under the law of California the death of the wife did not affect the fact that she had a vested ownership interest in the policies, one-half of their cash surrender value therefore fell into her estate, and this amount properly should be included in her gross estate for federal tax purposes. In order to determine the question of includibility for estate tax purposes, the nature of the wife's interest in the policies must be considered. This is, of course, a question of local property law. *Poe v. Seaborn*, 282 U.S. 101. Therefore, the community property law of California will be determinative of the question at hand.

It is incontrovertible that the policies in question were community property. Such was the holding of the court below (R. 45) in accordance with the stipulation of the parties that "These life insurance policies were purchased by the use of community property funds of plaintiff and decedent" (R. 29.) Where the premiums on insurance policies on the life of the husband are paid from community funds, the policies themselves are community assets, as are the proceeds at the death of the insured.³ *New York L. Ins. Co. v.*

³An exception has been engrafted to this general rule in the case of National Service Life Insurance policies. In *Wissner v. Wissner*, 338 U.S. 655, 661, the Supreme Court held that even though the insured's army pay, admittedly community property, had been used to pay the premiums, the wife was not entitled to one-half

Bank of Italy, 60 Cal. App. 602, 214 Pac. 61; *Travelers Ins. Co. v. Fancher*, 219 Cal. 351, 26 P. 2d 482; *Estate of Castagnola*, 68 Cal. App. 732, 230 Pac. 188; *Grimm v. Grimm*, 26 Cal. 2d 173, 157 P. 2d 841; *California Trust Co. v. Riddell*, 136 F. Supp. 7 (S.D. Cal.). See also *Union Pacific Mutual Life Ins. Co. v. Broderick*, 196 Cal. 497, 238 Pac. 1034; *Blethen v. Pacific Mut. Life Ins. Co.*, 198 Cal. 91, 243 Pac. 431; *Dixon Lumber Co. v. Peacock*, 217 Cal. 415, 19 P. 2d 233.

Under California law the surviving spouse takes a one-half interest in the proceeds of community property insurance on a decedent spouse's life, not as a beneficiary of the insurance policy, but as an owner of a one-half interest therein.⁴ *Manufacturers Life Ins. Co. v. Moore*, 116 F. Supp. 171 (S.D. Cal.); *Prudential Ins. Co. of America v. Harrison*, 106 F. Supp. 419 (S.D. Cal.). Thus, the survivor receives a portion of the proceeds, not because he or she was named a beneficiary of the policy, but rather as an owner who

of the insurance proceeds. The decision was based upon a congressional intent that the insured have complete control over the beneficiary of the insurance and that no person was to have a vested right to the proceeds. The Court recognized that the general rule as to Californians might be different: "However 'vested' her right to the proceeds of nongovernmental insurance under California law, that rule cannot apply to this insurance."

⁴These cases consider the situation of a surviving spouse, primary beneficiary of the decedent's insurance, who is guilty of manslaughter in connection with the death of the decedent. The general rule in California, as in most other states, bars a murderer from recovery of insurance on the victim's life, and the proceeds go to alternate beneficiaries if there are any. However, where the insurance has been purchased with community funds, the survivor-murderer has a vested interest in the proceeds to the extent of one-half of the surrender value of the policy.

has a vested interest in the policy. The remaining half interest in the policy was, of course, held by the other spouse at the time of death. Once it is determined that any given property has a community nature, it is necessary to determine whether it is old-type (pre-1927) or new-type (post-1927) community property. In the case at bar we are concerned only with new-type community property, acquired after July 29, 1927.⁵ On that date, Section 161a of the Civil Code (Appendix A, *infra*) was enacted. This section provides that—

The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests * * *

Thus, the decedent's interest in these policies at the time of her death was equal to that of her husband. One-half of the policies was owned by her and the other half by the husband. She had vested ownership interest which could not be taken from her without her consent. *Cooke v. Cooke*, 65 C.A. 2d 260, 150 P. 2d 514; *United States v. Malcolm*, 282 U.S. 792. There is nowhere to be found in the California cases or statutes any authority for the proposition that insurance policies and their proceeds are accorded

⁵See footnote 1, *supra*. As noted there, it was necessary to determine the source of premium payments, whether before or after the enactment of Section 161a of the Civil Code in 1927, in order to determine the extent to which each of the various insurance policies was new-type community property. See, e.g., *Modern Woodmen of America v. Gray*, 113 Cal. App. 729, 299 Pac. 754.

treatment different from that given to any other type of property held as a community asset. In fact, the many cases cited have considered various aspects of community property law in relation to insurance and have in each instance applied the same general concepts of community property law to insurance policies as are applied to other types of property. There is no question but that at the date of her death the decedent owned one-half of every policy here in question.

Although the wife has a vested interest in the community property (Civil Code, Section 161a), it has been provided that the husband has the management and control of the community property, with the same power of disposition (other than testamentary) which he has over his separate estate (Civil Code, Section 172 (Appendix A, *infra*)). The Code expressly limits and restricts the husband's management and control however, by the provision that he cannot make a gift of the community property, or dispose of it, without a valuable consideration unless he has the written consent of his wife. This limitation upon the husband has been held applicable to insurance policies as well as to any other form of community property. Thus, where the husband without his wife's consent has made a third party a beneficiary of his insurance, and the insurance was paid with community funds, it has been held that this was an attempt to make a gift by means of insurance, and such gift was a nullity as to the wife. As a result, *New York L. Ins. Co. v. Bank of Italy, supra*, held that in such a situation upon the death of the husband the wife was entitled to one-half

the proceeds of the policy. See also *Travelers Ins. Co. v. Fancher*, *supra*; *In re Stans Estate*, Myr. Prob. 5; *In re Webb*, Myr. Prob. 93. Compare *Blethen v. Pacific Mut. Life Ins. Co.*, *supra*; *Trimble v. Trimble*, 219 Cal. 340, 26 P. 2d 477. There was not, in this case, any written consent by the decedent, within the meaning of Civil Code Section 172, allowing the husband to make a gift of any portion of these insurance policies.⁶ The decedent wife did not give up her rights in the policies.

The application of the provisions of Civil Code Section 172 to the situation at bar is apparent. There is no question whatsoever as to the right of the husband to insure himself with community funds. This is a privilege granted him as manager of the community. But this privilege does not in any manner allow him to defeat his wife's interest in the property purchased with community assets, for as stated above, the section goes on to provide that the husband may not give away community assets, nor may he dispose of them without adequate consideration. Thus the California courts consistently have held that in the absence of a written consent the wife takes one-half of the proceeds of insurance on her husband's life as an owner thereof and it makes no difference whom he has desig-

⁶Compare the situation in *Ettlinger v. Connecticut General Life Ins. Co.*, 175 F. 2d 870 (C.A. 9th), where the surviving wife signed a written request changing the beneficiary of her husband's insurance to her husband's children by a prior marriage. In the case at bar, the decedent was primary beneficiary in each instance in which a consent was signed and her children or grandchildren were contingent beneficiaries.

nated as beneficiary.⁷ *New York L. Ins. Co. v. Bank of Italy, supra*; *Travelers Ins. Co. v. Fancher, supra*. The fact that in this case the husband took the policies in his own name did not serve to alter their community status in any respect.

The court below recognized the fact that these policies were part of the community, however, it refused to include the wife's interest in her gross estate. Implicit throughout the opinion of the lower court is the belief that insurance policies are somehow *sui generis* and the ordinary community property law does not apply. The following quotation from the opinion provides an illuminating example of the erroneous path onto which the court has wandered (R. 48-49):

This interest which Mrs. Stewart had in the insurance policies was, in effect, a right of protection; a right to upset during her lifetime as to one-half of [sic] the event that the proceeds were paid to a stranger on Mr. Stewart's death without her consent. But this right of protection did not enure to the benefit of anyone on her death since her death extinguished this right. Both before and after her death he had the right to take the cash surrender value of these policies without her consent, because he had the management and control of the community property. It was only

⁷A different result will obtain, of course, where the wife in writing consents to a gift (*Ettlinger v. Connecticut General Life Ins. Co., supra*), where the third party is named beneficiary for a valuable consideration (*Union Pacific Mutual Life Ins. Co. v. Broderick, supra*), and where the wife, knowing of the gift, fails to object to the insurance company until after the company in good faith paid the proceeds to the third party (*Blethen v. Pacific Mut. Life Ins. Co., supra*).

the dissipation of the cash surrender value during her lifetime by way of gift which she could prevent.

The local law in no manner supports the above statement. Thus, the cases, not to mention the applicable provisions of the Civil Code, make it clear that the wife's interest in the insurance policies was an interest vested and equal to that of her husband. In other words, she owned one-half of the policies. In the event of a divorce, the wife could properly claim one-half of the cash surrender value of the policies as her property (see, e.g., *Johnston v. Johnston*, 106 C.A. 2d 775, 236 P. 2d 212); her relinquishment of her rights on such insurance has been held valid consideration for an assignment by the husband to her of a mortgage (*Dixon Lumber Co. v. Peacock, supra*); and should she die prior to her husband, her interest in the policies will go to her heirs and not to the heirs of her husband (*Estate of Castagnola, supra*; Cf. *Mayr v. Arana*, 133 C.A. 2d 471, 284 P. 2d 21). Such rights are indeed much more substantial interests in property than a "right of protection." Such rights represent vested ownership interests in property which are not extinguished upon the death of the owner. Additionally, the wife has a clear-cut right of testamentary disposition of her community interest in insurance policies as well as any other type of community property. Probate Code, Section 201, (Appendix A, *infra*), provides that "upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is sub-

ject to the testamentary disposition of the decedent.” Had the decedent herein so desired, it would have been completely proper for her to have made testamentary disposition of her share of these twenty-six insurance policies, and under the Probate Code of the State of California, this disposition would have been effective. While the Probate Code does not purport to define the nature of community interests in property (*Trimble v. Trimble, supra*), it does set forth in unequivocal language the right of the decedent to make testamentary disposition of one-half of the community property. This is a general right relating to all community property and it applies to insurance policies in the name of the surviving husband. There is nowhere in the Probate Code an indication of a different rule for insurance policies.

Thus, at the time of her death, the decedent owned one-half of each of these insurance policies. The amount so held is therefore includible in her gross estate. Section 811 of the Internal Revenue Code of 1939 (Appendix A, *infra*) provides as follows:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

(a) *Decedent's Interest*.—To the extent of the interest therein of the decedent at the time of his death;

Under the clear language of subdivision (a) above, the insurance is includible in decedent's estate to the extent of her interest therein at the time of her death. At the time of her death, she had a one-half interest in the policies and to that extent the policies must be included in the estate. Such is the precise holding of *California Trust Co. v. Riddell*, *supra*, which correctly applied California law to this situation. See also *Estate of Carroll v. Commissioner*, 29 B.T.A. 11, wherein one-half of the value of Louisiana community property life insurance on the surviving husband's life was included in the estate of decedent wife. The District Court, however, chose to follow a decision based on Washington law and which arose under different provisions of the Internal Revenue Code, *Waechter v. United States*, 98 F. Supp. 960 (W.D. Wash.), affirmed on other grounds, 195 F. 2d 963 (C.A. 9th). The District Court in *Waechter* considered the situation where the decedent wife was beneficiary of three insurance policies taken out by her surviving husband with Washington community funds during her lifetime. The wife's executor included in her estate one-half the cash surrender value of these policies, then sued for refund. It was the position of the Government that the cash surrender value of the policies was community property and that one-half of this was subject to the wife's power of testamentary disposition under the Washington statutes. The decedent in *Waechter* died on February 20, 1947, when the Revenue Act of 1942 was in effect, and Section

811(e)(2)⁸ thereof could be interpreted as providing that where a wife predeceased her husband, only so much of the community property was includible in her estate as she had power of testamentary disposition thereover. The holding that the wife's interest in the insurance policies was not includible in her gross estate was based upon a state supreme court decision (*In re Knight's Estate*, 31 Wash. 2d 813, 199 P. 2d 89), which held that in the case of policies payable on the death of an insured, who is the surviving spouse, nothing whatever became payable on the death of the beneficiary, the deceased wife, and that therefore no interest in the policies or in the cash surrender value thereof passes to the heirs of the deceased beneficiary. On appeal the Government admitted that in Washington the insurance interest would not pass by will or inheritance, and urged another ground of recovery. The decision of the District Court was affirmed when this Court refused to allow the Government to argue

⁸The Internal Revenue Code of 1939, Section 811(e)(2), as amended by Section 402 of the Revenue Act of 1942, c. 619, 56 Stat. 798, provided as follows:

(e) *Joint and Community Interests.*—

* * * * *

(2) *Community interests.*—To the extent of the interest therein held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition.

a point not presented to the lower court. *United States v. Waechter*, 195 F. 2d 963. Thus the question presented in this case has never been decided by this Court.

The community property provisions of the 1942 Act were repealed by Section 351 of the Revenue Act of 1948, c. 168, 62 Stat. 110, effective with respect to estates of decedents dying after December 31, 1947. Since the decedent in the case at bar died in 1951, it is apparent that *Waechter*, based as it was upon the 1942 Act and its requirement of testamentary disposition, has no application. There is presently no requirement of testamentary disposition, although as pointed out above Probate Code Section 201 makes it clear that in California the decedent herein had a right of testamentary disposition. However, mere beneficial ownership at time of death is presently sufficient for estate tax purposes. The estate tax is imposed, not upon the right to succeed to property at death or upon the right to receive property by devise, descent or distribution, but is rather "an excise upon the transfer of an estate upon the death of the owner." *May v. Heiner*, 281 U.S. 238, 244. This Court in *Commissioner v. Clise*, 122 F. 2d 998, carefully examined the nature of the federal excise tax, while specifically considering the includibility of an interest transferred at the time the holder of an annuity policy died. It was stated (pp. 1001-1002):

The Federal Estate Tax is levied upon the privilege of transmission of property at death. *Saltonstall v. Saltonstall*, 276 U.S. 260, 270, 48 S. Ct.

225, 72 L. Ed. 565. It is "death duties," as distinguished from a legacy or succession tax. It does not tax the interest to which the legatees and devisees succeed on death, but the interest which ceased by reason of death; what is imposed is an excise upon the transfer of an estate upon death of the owner. *Nichols v. Coolidge*, 274 U.S. 531, 537, 47 S. Ct. 710, 71 L. Ed. 1184, 52 A.L.R. 1081; *Young Men's Christian Ass'n v. Davis*, 264 U.S. 47, 50, 44 S. Ct. 291, 68 L. Ed. 558; *Edwards v. Slocum*, 264 U.S. 61, 62, 44 S. Ct. 293, 68 L. Ed. 564; *Knowlton v. Moore*, 178 U.S. 41, 47, 49, 20 S. Ct. 747, 44 L. Ed. 969. The Supreme Court, in *Reinecke v. Northern Trust Co.*, 278 U.S. 339, 347, 49 S. Ct. 123, 125, 73 L.Ed. 410, 66 A.L.R. 397, said, "In its plan and scope the tax is one imposed on transfers at death or made in contemplation of death and is measured by the value at death of the interest which is transferred." Death is said to be the generating event. *Tyler v. United States*, 281 U.S. 497, 502, 50 S. Ct. 356, 74 L.Ed. 991, 69 A.L.R. 758.

If the lower court was correct in holding that the policies are assets of the community, and it is submitted that this portion of the opinion is correct, then it is apparent that upon the death of the decedent something had to happen to her interest in the policies. Because of her death, she ceased to hold an interest in the policies, and such interest passed to her estate, to her husband or to the beneficiaries of the policies. Such a passing in itself is sufficient to require the policies to be included in decedent's gross estate under Section 811(a) of the Code.

Assuming for the purposes of argument only, however, that the husband's action in investing the community assets in insurance in his name had the effect of making a gift on the part of the wife, either to himself or to the beneficiaries, half of the insurance is still includible in her estate. The California cases relating to gifts of community property made by the husband without the written consent of the wife have generally termed such gifts voidable. See, e.g., *Blethen v. Pacific Mut. Life Ins. Co., supra*.⁹ The lower court held that if the wife did not take steps to invalidate such a gift during her lifetime, it became valid upon her death. In other words, the wife's failure to exercise her right to void the gift made it valid. If such be the case, the half interest of the wife is still includible in her gross estate, either under the provisions of Section 811(c)(1)(C) or 811(d) of the Code. Section 811(c)(1)(C) includes in gross estate any interest which a decedent has transferred "intended to take effect in possession or enjoyment at or after his death." If decedent is considered to have made a transfer of her interest in the insurance policies, either to her husband or to the contingent beneficiaries, it is clear that she had a right at least until the time of her death, to recapture such interest.¹⁰ Any

⁹The cases arose, in the main, in the pre-1927 period when the husband had title to the community property and the interest of the wife was no more than an expectancy. It would appear that as to post-1927 community property, since the wife has an interest equal to that of her husband, any similar gift would be completely void *ab initio*.

¹⁰Of course, under the Government's view of the law, she had much more than a right of protection, her right extended to dispose of this interest by will under Probate Code Section 201.

transfer, therefore, was one which could not take effect until after her death, and the property so transferred must be included in the estate. Similarly, Section 811(d) includes in gross estate any interests transferred where the enjoyment thereof was subject at the date of death to any change through the exercise of a power to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death. If a voidable gift has been made in this case, it might have been revoked by decedent up until the time of her death within the meaning of Section 811(d). Should it be held, therefore, that the wife's interest in the policies has somehow been divested by the action of the husband herein, the interest is still includible in her gross estate under either Section 811(c)(1)(C) or (d), because at the time of her death she retained the right to void the attempted gift by insurance by her husband. In the posture of the case at bar, however, it would seem more correct under the state cases to hold that at the time of her death the decedent held a half interest in the policies as a vested owner. Such interest would therefore be includible under Section 811(a).

The Supreme Court, in *Lang v. Commissioner*, 304 U.S. 264, held that upon the death of a husband, with a wife surviving, only one-half of the proceeds of his life insurance (purchased with community funds) is includible in his estate. It is therefore only logical that upon the wife's prior death the other one-half interest which she owns should be included in her estate. To hold otherwise would mean that a husband

can purchase life insurance upon his life, with community assets, deplete his wife's estate for the purposes of estate tax in the event that she predecease him, while being assured that only one-half of the proceeds will be included in his estate should he be the first to die. The opinion of the court below in effect allows the taxpayer to eat his cake and have it too. It is incorrect and should be reversed.

II.

THE ANNUITY POLICIES ISSUED TO THE WIFE WERE HER SEPARATE PROPERTY AND THEIR FULL VALUE IS INCLUDIBLE IN HER GROSS ESTATE.

Seven annuity policies were issued to the decedent in 1934 and 1935. (Exs. C, D, E, F.) The premiums on these policies, as the premiums on the husband's insurance policies, were paid with community funds. (R. 29, 40.) Each policy, a written instrument, named the decedent as annuitant. In each the decedent was described as the person having the right to name or change beneficiaries at any time. (R. 39.) She further had the right to make loans up to the amount of the cash surrender value of the policies and could surrender the contracts to the company and receive the cash surrender value thereof. Originally, the husband was designated primary beneficiary of each policy; later changes by decedent substituted the daughter as primary beneficiary. It is the position of the Government that all seven of these annuity policies were the separate property of the decedent and that

consequently their full value is includible in her gross estate under Section 811(a) of the Code.

Generally speaking, in determining the status of property held by husband or wife, the presumption is that it belongs to the community. However, Section 164 of the California Civil Code (Appendix A, *infra*) expressly modifies this rule in certain instances of property held by the wife. The section and its early history are discussed in *Nevins v. Nevins*, 129 C.A. 2d 150, 153, 276 P. 2d 655, as follows:

From the earliest period of California history courts have adhered to the Spanish law rule accepted in community property states that the presumption attending the possession of property by either a husband or wife is that it belongs to the community. Exceptions to the rule must be proved, and the burden rests with the claimant of the separate estate. (*Meyer v. Kinzer* (1859), 12 Cal. 247 [73 Am. Dec. 538]. *Wilson v. Wilson* (1946), 76 Cal. App. 2d 119 [172 P. 2d 568].)

In 1889, however, by direct statutory change, the foregoing general rule was modified as to properties held in the wife's name. In those situations, according to the addition to Civil Code section 164, where property is acquired during marriage by a married woman by an instrument in writing, the presumption is not that the property is community, but the contrary, that it is separate. (*Armstrong*, California Family Law, pp. 440-441; 10 Cal. Jur. 2d 713.) The burden is then upon the husband seeking to claim the property for the community. (*Dunn v. Mullan*, 211 Cal. 583 [296 P. 604, 77 A.L.R. 1015]; *Pearson*

v. Hellman Commercial etc. Bank, 199 Cal. 305 [249 P. 10].) Originally this portion of Civil Code, section 164, was limited to conveyances of real property (*Stafford v. Martinoni*, 192 Cal. 724 [221 P. 919]; 12 Cal. L. Rev. 421) but a further amendment in 1927 extended its application to acquisition of any interest in or encumbrance on real or personal property. (10 Cal. Jur. 2d 715).

As against the husband, the presumption is disputable, and may be controverted by other evidence, direct or indirect. But the evidence to overthrow the presumption must be "clear and convincing" (*Attebury v. Wayland*, 73 Cal. App. 2d 1, 5 [165 P. 2d 524].)

It can be seen, therefore, that these policies are presumptively the separate property of the decedent, for they are "personal property * * * acquired by a married woman by an instrument in writing." *Estate of Lissner*, 27 C.A. 2d 570, 81 P. 2d 448. This presumption is, of course, disputable and it is susceptible of being overcome by other evidence, but in the absence of such controverting evidence, the court or jury is bound to find in accord with the presumption; for the presumption itself is a form of evidence. *Palmer v. Palmer*, 101 C.A. 2d 819, 226 P. 2d 613; *Stafford v. Martinoni*, 192 Cal. 724, 221 Pac. 919; *Nichols v. Mitchell*, 32 Cal. 2d 598, 197 P. 2d 550. There is nowhere to be found any indication that the husband did not wish decedent to hold these policies as her separate property, and there was no testimony at all as to the intent of the parties at the time the

policies were issued, or indeed, as to their intent at any time during the existence of the policies.

The District Court fell into error by failing to consider the exception carved by Section 164 out of the general rule that property held by husband and wife is presumably community property. Instead, the court mistakenly held that under California law these policies were prima facie community property (R. 40), and then went on to state that there was no substantial evidence in the record that the policies (other than the Fidelity policies) became decedent's separate property by means of a gift from her husband. In addition to ignoring completely the statutory presumption that the policies were separate property (Section 164 was not mentioned in the opinion below), the court also failed to consider the long line of cases concerning transfers by the husband to the wife. These cases hold that if a husband transfers his separate or community property to his wife, the mere fact of transfer raises the prima facie presumption that he intended the transfer to be a gift. *Dunn v. Mullan*, 211 Cal. 583, 589, 296 Pac. 604; *Ballinger v. Ballinger*, 9 Cal. 2d 330, 333, 70 P. 2d 629; *Ayoob v. Ayoob*, 74 C.A. 2d 236, 254, 168 P. 2d 462; *Pasadena Trust etc. Bank v. Bryson*, 46 Cal. App. 730, 733, 189 Pac. 816; *Estate of Horn*, 102 C.A. 2d 635, 228 P. 2d 99. There is no dispute about the fact that the premiums were paid with community funds. Since the husband had the management and control of such community funds (Civil Code Section 172), the funds must have been used with his consent.

In effect, by allowing community funds to be used to pay premiums on policies taken out in the name of the decedent alone, he was transferring the funds to the wife. In such situations the courts have stated that the property became separate property of the wife even without the formality of a written instrument. *Nevins v. Nevins, supra*. Of course, the situation becomes much more clear cut when the property itself is evidenced by a written instrument, as happened in the case at bar. Thus, in the situation at bar there are two presumptions that the property was held by decedent as her separate estate, the first arising because the property interest was acquired by an instrument in writing, and the second arising because the husband who manages and controls the community property transferred the same to his wife.

Life insurance on the wife's life was considered in a husband's suit for a share of the proceeds in *Pacific Mut. Life Ins. Co. v. Cleverdon*, 16 Cal. 2d 788, 108 P. 2d 405. The holding that the beneficiary, and not the husband, took all of the proceeds of the wife's insurance was based upon two grounds. The first of these was that the premiums were paid from the wife's earnings and the parties had informally agreed that these earnings were separate property of the wife. Secondly, the court held that even if the premiums were paid from community funds, they were paid with the knowledge and consent of the husband and he was not entitled to share in the proceeds. In effect, the court was saying that the husband had given his wife his share of the premiums which were paid on the policies.

The court below misconstrued the effect of certain action which was taken with respect to various changes of beneficiaries made by the decedent. The daughter was substituted on each of the policies as primary beneficiary in place of the husband. This substitution was made on the Fidelity policies in 1948, and then in 1950 when the decedent elected to change the mode of payment the husband signed a statement addressed to the insurance company in which he relinquished all his community rights in the policies. (R. 37; Ex. C.) As to these policies the court held that a gift had been made to decedent and that they became her separate property. (R. 44.) Similar action was taken by decedent with respect to each of the other policies. In 1948 the daughter was substituted as primary beneficiary and in 1950 there was an election to change the mode of payment. The husband's acquiescences in these changes of beneficiary were as follows: Hancock policies, the husband signed the form under which the change of beneficiary was requested (R. 38; Ex. D); Equitable policy, husband signed below a line reading: "I hereby agree to the foregoing beneficiary provisions. Signature of Annuitant's husband" (R. 38; Ex. F); Aetna policies, husband signed the request form on the line provided for the signature of "Witness" (R. 39; Ex. E). Discussing the express relinquishment of community rights by the husband in the Fidelity policies, the court below stated (R. 41):

As to those policies there is no doubt that they were Mrs. Stewart's separate property at the time of her death, but the fact that he saw fit

not to do the same thing with his interest in the other policies is strong evidence that he did not intend to make a gift of them, but rather intended to retain his community interest.

This statement, it is submitted, places undue emphasis upon the Fidelity Mutual form which the husband signed. The mere fact of signing such a form is not evidence that the husband had a community interest in the policies. The form, it should be noted, states in part as follows (Ex. C):

I, hereby, relinquish any and all community property rights I may have in said policies and in all payments made or to be made thereunder by your Company, and in all premiums paid or to be paid in connection with said policies; and authorize your Company to deal with said policies as the separate [sic] property of my said wife.

The form, while effective for purposes of relinquishing any community rights which the husband might have had, does not in any manner prove that he had such rights, and indeed there is nowhere in the form any indication that the husband had any community interest in the policies. All that the form stated was that if he had any such rights he was giving them up.

On the other hand, the court apparently gave no consideration at all to the fact that as to three of the remaining five policies the husband gave unqualified assent that the proceeds be paid to a beneficiary other than himself (Hancock and Equitable policies), and on the remaining two policies signed the request for such a change as a "Witness" (Aetna policies).

This Court, in *Ettlinger v. Connecticut General Life Ins. Co.*, 175 F. 2d 870, considered a somewhat comparable situation. In that case the decedent insured and his wife both signed a written request that his daughters be the beneficiaries of his life insurance. After some payments had been made to the daughters, the wife claimed an interest because part of the premiums had been paid with community property. This Court held that an unqualified assent that the proceeds be paid to the daughters was a sufficient consent in writing that the wife was giving up her community interest in the policy to meet the requirements of Civil Code Section 172. If such a consent suffices to deprive the wife of her community interest it must be more than sufficient to deprive a husband of any community interest which he might have in the policies. Although it is felt that under the California law these policies have been the separate property of decedent ever since they were first issued to her, should the Court for some reason reach a contrary decision, it is apparent from the *Ettlinger* case that the policies became separate property of the decedent at the time her husband signed the change of beneficiary forms.

The court below erred in holding that the Hancock, Equitable and Aetna policies were not the separate property of decedent. The full value of all of the policies should be included in decedent's gross estate.

CONCLUSION.

The decision of the court below was incorrect and should be reversed.

Respectfully submitted,

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July, 1958.

(Appendices A and B Follow.)



Appendices.



Appendix A

Civil Code of California:

Sec. 161a. *Community property; interests of parties defined.*

The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property. (Added Stats. 1927, c. 265, p. 484, §1.)

Sec. 162. *Separate property; wife.*

SEPARATE PROPERTY OF THE WIFE.

All property of the wife, owned by her before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof, is her separate property. The wife may, without the consent of her husband, convey her separate property. (Enacted 1872.)

Sec. 164. *Community property; presumptions as to property acquired by wife; limitation of actions.*

All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this State, is community property; but whenever any real

or personal property, or any interest therein or encumbrance thereon, is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property, and if acquired by such married woman and any other person the presumption is that she takes the part acquired by her, as tenant in common, unless a different intention is expressed in the instrument; except, that when any of such property is acquired by husband and wife by an instrument in which they are described as husband and wife, unless a different intention is expressed in the instrument, the presumption is that such property is the community property of said husband and wife. The presumptions in this section mentioned are conclusive in favor of any person dealing in good faith and for a valuable consideration with such married woman or her legal representatives or successors in interest, and regardless of any change in her marital status after acquisition of said property.

* * * (Enacted 1872. As amended Stats. 1889, c. 219, p. 328, §1; Stats. 1893, c. 62, p. 71, §1; Stats. 1897, c. 72, p. 63, §1; Stats. 1917, c. 581, p. 827, §1; Stats. 1923, c. 360, p. 746, §1; Stats. 1927, c. 487, p. 826, §1; Stats. 1935, c. 707, p. 1912, §1; Stats. 1941, c. 455, p. 1752, §1.)

Sec. 172. *Community personal property; management and control; restrictions on disposition.*

The husband has the management and control of the community personal property, with like absolute power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such community personal property, or dispose of

the same without a valuable consideration, or sell, convey, or encumber the furniture, furnishings, or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife. (Enacted 1872. As amended Stats. 1891, c. 220, p. 425, §1; Stats. 1901, c. 190, p. 598, §1; Stats. 1917, c. 583, p. 829, §1.)

Probate Code of California:

Sec. 201. *Title of surviving spouse; portion subject to testamentary disposition or succession.*

Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse subject to the provisions of sections 202 and 203 of this code. (Stats. 1931, c. 281, p. 595, §201, as amended Stats. 1925, c. 831, p. 2249, §2.)

Internal Revenue Code of 1939:

Sec. 811. Gross Estate.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

(a) *Decedent's Interest.*—To the extent of the interest therein of the decedent at the time of his death;

* * *

(c) [As amended by Sec. 7(a) of the Act of October 25, 1949, c. 720, 63 Stat. 891] *Transfers*

or personal property, or any interest therein or encumbrance thereon, is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property, and if acquired by such married woman and any other person the presumption is that she takes the part acquired by her, as tenant in common, unless a different intention is expressed in the instrument; except, that when any of such property is acquired by husband and wife by an instrument in which they are described as husband and wife, unless a different intention is expressed in the instrument, the presumption is that such property is the community property of said husband and wife. The presumptions in this section mentioned are conclusive in favor of any person dealing in good faith and for a valuable consideration with such married woman or her legal representatives or successors in interest, and regardless of any change in her marital status after acquisition of said property.

* * * (Enacted 1872. As amended Stats. 1889, c. 219, p. 328, §1; Stats. 1893, c. 62, p. 71, §1; Stats. 1897, c. 72, p. 63, §1; Stats. 1917, c. 581, p. 827, §1; Stats. 1923, c. 360, p. 746, §1; Stats. 1927, c. 487, p. 826, §1; Stats. 1935, c. 707, p. 1912, §1; Stats. 1941, c. 455, p. 1752, §1.)

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Internal Revenue Code of 1939:

Sec. 811. Gross Estate.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

(a) *Decedent's Interest.*—To the extent of the interest therein of the decedent at the time of his death;

* * *

(c) [As amended by Sec. 7(a) of the Act of October 25, 1949, c. 720, 63 Stat. 891] *Transfers*

in Contemplation of, or Taking Effect at, Death—

(1) *General rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

* * *

(C) intended to take effect in possession or enjoyment at or after his death.

* * *

(3) *Transfers taking effect at death—transfers after October 7, 1949.*—An interest in property transferred by the decedent after October 7, 1949, shall be included in his gross estate under paragraph (1)(C) of this subsection (whether or not the decedent retained any right or interest in the property transferred) if and only if—

(A) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent; * * *

* * *

(d) *Revocable Transfers.*—

(1) *Transfers after June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a

power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death;

* * *

(3) *Date of existence of power.*—For the purposes of this subsection the power to alter, amend, or revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

* * *

(26 U.S.C. 1952 ed., Sec. 811.)

Appendix B

Table of Exhibits

All exhibits filed in this cause were attached to the stipulation of facts. (R. 24-33.) By stipulation of the parties (R. 64), the insurance and annuity policies attached to the stipulation of facts are designated as part of the record on appeal, but are not incorporated in the printed transcript of record. For the convenience of the Court, the following is a list of these policies:

Exhibit	Company	Policy number	Similar policies not of record
DECEDENT'S ANNUITY POLICIES ¹¹			
C	Fidelity Mutual	521823	521822
D	John Hancock	0128263	0128280
E	Aetna	AP 1850	AP 1849
F	Equitable	9685846	
HUSBAND'S INSURANCE ¹²			
H	Equitable	2370306	1926372 2249133 1926371 2387397 2387396 2387398 2796071 409015
I	Travelers	409014	409015
J	Pacific Mutual	336749	
K	Mass. Mutual	459078	
L	Aetna	530811	
M	Equitable	9577484	9577482
N	Mutual Life	25198	25197
O	New York Life	123101	
P	New York Life	123837	123838
Q	John Hancock	020695	
R	Mutual Benefit	838189	838190
S	West Coast Life	97457	
T	Aetna	778050	778051

¹¹See Ex. B for summary tabulation.

¹²See Ex. G for summary tabulation.

No. 16,014

IN THE

**United States Court of Appeals
For the Ninth Circuit**

UNITED STATES OF AMERICA,

Appellant,

VS.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,

Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

BRIEF FOR THE APPELLEE.

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FILED

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PAUL R. MURPHY, CLERK





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vs.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,

Appellee.

**On Appeal from the Judgment of the United States District Court
for the Northern District of California.**

BRIEF FOR THE APPELLEE.

OPINION BELOW.

The opinion of the District Court (Tr. 34-49) is reported at 158 F. Supp. 25.

JURISDICTION.

This appeal involves federal estate taxes. The taxes in dispute plus interest in the total amount of \$222,357.11 were paid on or about August 24, 1954 (Tr. 55).

Claim for refund was filed on or about March 10, 1955 (Tr. 15-19), and the Commissioner of Internal Revenue rejected the claim on March 21, 1956 (Tr. 8, 10, 21, 23). Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on July 3, 1956, the taxpayer brought an action in the District Court for recovery of the taxes paid (Tr. 3-19). Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment was entered on March 17, 1958 (Tr. 56-57). Within sixty-days and on May 2, 1958, a notice of appeal was filed (Tr. 58). Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED.

I.

Whether the Court below erred in holding that upon Mrs. Stewart's death, her interests in life insurance policies, premiums on which were paid from community funds, covering her surviving husband's life, were at no time the subject of transfers of property taxable under the federal estate tax laws;

II.

Whether the Court below erred in holding that the rights of beneficiaries to receive annuities upon the death of Mrs. Stewart under certain contracts between her and insurance companies, assented to by her husband, and relating to the deposit and dispo-

sition of community funds, were includible in Mrs. Stewart's gross estate for federal estate tax purposes only to the extent of one-half the value of said rights rather than the full value.

STATUTES INVOLVED.

These appear in the Appendix, *infra*.

STATEMENT.

Three issues were presented to the Court below. One of these issues (First Cause of Action) was conceded by the Government. A second issue (Second Cause of Action), that concerning the inclusion in Mrs. Stewart's gross estate of all or just part of the proceeds of life insurance annuity policies payable to her and upon her death to others, was decided by the Court below partly in favor of the Government and partly in favor of the taxpayer. The third issue (Third Cause of Action), that concerning the inclusion in Mrs. Stewart's gross estate of one-half the cash surrender value of insurance policies on the life of her surviving husband, was decided by the Court below in favor of the taxpayer. The Government has appealed from the determinations of the Court below adverse to it, excepting of course as to the first issue, as to which it acknowledged error.

The case was tried entirely on the pleadings and a written stipulation of facts (Tr. 34).

Ashby O. (or A. O.) and Mary Stewart were married in 1906 and their marital relationship continued until Mary's death on February 21, 1951. At all times pertinent to this case they were residents of California (Tr. 25, 34-35).

At the time of death of Mary W. Stewart there existed twenty-six policies of insurance covering the life of decedent's husband, Ashby O. Stewart. No part of the value of these policies was reported in the Federal estate tax return for the estate of Mary W. Stewart. Upon audit of that return the Commissioner of Internal Revenue determined that one-half of the \$751,178.85 cash value of these policies at the time of her death, or \$375,589.42, should be included in the decedent's gross estate (Stip. para. 17, Tr. 29).

These life insurance policies were purchased by payment of premiums out of the community property funds of Mr. and Mrs. Stewart (Stip. para. 17, Tr. 29).

Plaintiff and his wife Mary W. Stewart had no transactions and no agreements with respect to these insurance policies other than those disclosed by said policies and documents attached to said policies (Stip. para. 18, Tr. 30).

The following tabulation is a quick reference to certain pertinent rights under the respective policies:

Policies Under Which Wife Was Named Primary Beneficiary, and Others Named as Contingent Beneficiaries		Designation of Beneficiary Consented to by Wife		Right to Change Beneficiary or Surrender Policy Retained by Husband	
Number of Policies	Name of Insurer	Yes	No	Yes	No
1	Pacific Mutual		x	x	
1	Aetna		x	x	
8	Equitable	x		x	
2	Travelers	x		x	
1	Massachusetts Mutual	x		x	
2	Mutual of New York*		x	x	
2	Equitable	x		x	
3	New York Life	x			x
1	John Hancock	x			x
2	Aetna		x	x	

*Could not take cash surrender value.

Policies Under Which Daughter or Grandchildren Were Named Primary Beneficiaries, and Wife Named as Contingent Beneficiary		Designation of Beneficiary Consented to by Wife		Right to Change Beneficiary or Surrender Policy Retained by Husband	
Number of Policies	Name of Insurer	Yes	No	Yes	No
2	Mutual Benefit		x	x	
1	West Coast		x	x	

The Government contended that Mrs. Stewart's community property interest was includible in her gross estate under Sections 811(a), (c) or (d) of the Internal Revenue Code of 1939 (Tr. 45).

The Court below concluded that Mrs. Stewart's community property interest in these policies was in effect a right of protection; a right to upset during her lifetime as to one-half in the event that the proceeds were paid to a stranger on Mr. Stewart's death without her consent (Tr. 48-49). The Court concluded this right was extinguished upon her death (Tr. 49), and that with respect to this right there was no tax-

able transfer occasioned by the wife's death and there was no interest to which the estate tax would attach (Tr. 46, 47, 49), and therefore the Government was in error in including a value for these policies in the wife's taxable estate (Tr. 49).

In Schedule D of the Federal Estate Tax Return filed by the estate of the decedent, Mary W. Stewart (Exhibit "A" attached to Stip.), plaintiff reported certain annuity insurance policies, the proceeds of which were payable to named beneficiaries other than decedent or her estate, upon the death of the decedent. These policies were purchased through payment of premiums out of community property funds of plaintiff and decedent, and Mrs. Stewart was the insured. The total valuation of said proceeds upon the date of decedent's death was \$130,416.16. Plaintiff reported only one-half of the full value of the said proceeds for estate tax purposes, or \$65,208.08 (Stip. para. 15, Tr. 29).

In the audit of the aforementioned estate tax return the Commissioner of Internal Revenue determined that the above-mentioned life insurance reported in Schedule D of the estate tax return was the separate property of the decedent Mary W. Stewart, and increased the valuation thereof in the decedent's gross estate by an additional amount of \$65,208.08, to a total valuation of \$130,416.16, which was the full value of the said life insurance proceeds upon the date of the decedent's death (Stip. para. 16, Tr. 29).

Plaintiff and his wife Mary W. Stewart had no transactions and no agreements with respect to these

insurance policies other than those disclosed by said policies and documents attached to said policies (Stip. para. 18, Tr. 30).

In all these policies Mr. Stewart was described as the husband of the beneficiary. He was originally named a beneficiary and when his designation of beneficiary was changed he expressed his consent to or authorization of his wife's actions in the following manner:

In the John Hancock policies (Ex. D) this authorization in 1946 and 1948 is expressed, "The insured's husband, Ashby O. Stewart, hereby joins in the foregoing election of settlement option and authorizes and requests the company to comply with the terms hereof."

In the Aetna policies (Ex. E) this authorization in 1950 is expressed in a statement signed "Mary Woods Stewart, Annuitant" and "Ashby O. Stewart, husband of Annuitant", "Application is hereby made for payment of the cash value of Policy No. issued on the life of Mary Woods Stewart. . . . The Company is hereby authorized to make any necessary change in beneficiary of said policy to enable the undersigned alone to surrender said policy as herein requested. Settlement of proceeds to be made in accordance with my letter of November 9, 1950". The letter of November 9, 1950 is written on the letterhead of A. O. Stewart, and is signed by Mary W. Stewart, and instructs as to the payment of the annuities.

In the Equitable policies (Ex. F) this authorization in 1948 is expressed, "I hereby agree to the fore-

going beneficiary provisions. Signature of Annuitant's husband''.

In contrast the endorsement on the Fidelity policies (Ex. C) was a specific transfer of community rights as follows: "I, Ashby Oliver Stewart, am the spouse of the owner of policies Nos. 581822-581823 issued by your Company on the life of Mary Woods Stewart. I hereby relinquish any and all community property rights I may have in said policies and in all payments made or to be made thereunder by your Company, and in all premiums paid or to be paid in connection with said policies as the separate property of my said wife. . . ." Signed "Mary Woods Stewart" and "O.K., Ashby Oliver Stewart".

Both taxpayer and Government referred to Section 811(g) of the Internal Revenue Code of 1939, in support of their positions, the taxpayer contending further that under that section perhaps no part of the value of these policies was includible in the wife's estate.

The Court concluded that because these policies were annuity policies rather than insurance policies, Section 811(g) was not applicable (Tr. 41, 43). The Court further concluded that the wife's interest in the value of the proceeds which were payable upon her death was includible in her gross estate under Section 811(a) of the Internal Revenue Code of 1939, and also that her interest so includible was merely her community property interest which was one-half the value of such proceeds (Tr. 43, 44), excepting as to the Fidelity policies as to which the Court agreed

with the Government that since the husband had specifically transferred his community interest to his wife, the entire value of the proceeds payable under that policy was includible in the wife's gross estate.

ARGUMENT.

I.

THE COMMUNITY PROPERTY INTEREST OF THE WIFE IN THE INSURANCE POLICY COVERING HER HUSBAND'S DEATH, PREMIUMS FOR WHICH WERE PAID OUT OF COMMUNITY FUNDS, WAS A RIGHT OF PROTECTION WHICH WAS PERSONAL TO HER AND WAS EXTINGUISHED BY HER DEATH. SHE HAD NO PROPERTY INTEREST IN SAID POLICIES WHICH WAS AT ANY TIME THE SUBJECT OF TRANSFERS TAXABLE UNDER THE FEDERAL ESTATE TAX LAWS.

The Government contends that one-half the cash surrender value of insurance policies insuring the life of the surviving husband is includible in the gross estate of the deceased wife, where the premiums paid on those policies were paid out of community funds. The Government contends that the one-half of the cash surrender values of these policies on the date of the wife's death represented her "interest therein . . . at the time of her death" within the meaning of Section 811(a) of the Internal Revenue Code of 1939 requiring that there be included in the decedent's gross estate for Federal Estate Tax purposes the value at time of death of property "to the extent of the interest therein of the decedent at the time of his death".

It is conceded by the Appellee herein that the insurance policies were a form of community property

and the Court below so held (Tr. 45). It is also conceded that the wife has power to dispose by will of whatever disposable interest in community property she may have at the time of her death. The question at issue here is: What was the nature and extent of the community property interest of the decedent in the insurance policy at the time of her death, and was it something includible in her gross estate?

The Government's contention is predicated upon the Government's conclusion that "had the decedent herein so desired, it would have been completely proper for her to have made testamentary disposition of her share of these twenty-six insurance policies, and under the Probate Code of the State of California this disposition would have been effective" (Appellant's brief p. 20, repeated in effect p. 23, p. 19, p. 13). This is not the law. If it were so the Government would be correct in its contention. Both Judge Yankwich, the trial Judge in the case of *Waechter v. U. S.*, 98 F. Supp. 960 (W.D.Wash.), and Judge Hamlin in this case stated the law on this point to be to the contrary. Judge Hamlin concluded (Tr. 48) after referring to California Civil Code Section 172:

"In the realm of insurance law, this last cited code section has been held to give the wife the right to upset the payment of one-half of the proceeds of policies on the husband's life to a stranger. *Mazman v. Brown* (1936), 12 C.A. 2d 272, 55 P. 2d 539. However, the wife's right to contest is not activated until the death of the insured husband, when the gift was completed.

Further, if she did not take any steps to invalidate the gift during her lifetime, it became valid upon her death. *Mayr v. Arana* (1955), 133 C.A. 471, 284 P. 2d 21.

“This interest which Mrs. Stewart had in the insurance policies was, in effect, a right of protection; a right to upset during her lifetime as to one-half in the event that the proceeds were paid to a stranger on Mr. Stewart’s death without her consent. But this right of protection did not enure to the benefit of anyone on her death since her death extinguished this right. Both before and after her death he had the right to take the cash surrender value of these policies without her consent, because he had the management and control of the community property. It was only the dissipation of the cash surrender value during her lifetime by way of gift which she could prevent.

“However this right might be classified, I do not believe it comes within the purview of those subsections of the Internal Revenue Code cited by the Government. The principle of the *Waechter* case, *supra*, appears to me to be equally applicable to California community property law.”

The *Waechter* case was affirmed by this Circuit, *United States v. Waechter*, 1952, 195 F. (2d) 963. (Appellant states in its brief p. 21 “affirmed on other grounds”. This Appellate Court refused to hear issues not raised in the trial court, but the Court did affirm the judgment of the trial court.) The significance of the *Waechter* case as decisive of the exact issue involved in this proceeding cannot be more

clearly illustrated than by this Court's description of the case and of the trial court's conclusion therein as to the law. This Court said:

“The theory on which the government defended below appears to have been simply that the cash surrender value of the policies was community property, hence the wife's interest was subject to her power of testamentary disposition under Remington's Revised Statutes of Washington, Sec. 1342. The trial court was of the opinion that no part of the cash surrender value was includable in view of the holding in *In re Knight's Estate*, 31 Wash.2d 813, 199 P.2d 89, decided in 1949. The Washington court there decided that in the case of policies payable on the death of an insured, nothing whatever becomes payable on the death of a beneficiary prior to the insured's death, and thus no interest in the policies or in the cash surrender value thereof passes to the heirs of the deceased beneficiary.” 195 F.(2d) at 963-4.

This Appellate Court then goes on to say that “On its appeal the Government does not contend that the law of the state is otherwise than has been declared in the *Knight's Estate* decision. However, it seeks a reversal on a theory apparently not urged below. Its reliance here is placed on Section 811(e)(2) of the Internal Revenue Code . . .” The Court then refused to consider this theory and affirmed the judgment of the Court below.

The Section 811(e)(2) involved in the *Waechter* case and the part thereof which the Government urged in the appeal was repealed and was not in

effect at the time of Mrs. Stewart's death (Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 402 (26 U.S.C. 1952 ed., Sec. 811); Revenue Act of 1948, c. 168, 62 Stat. 110, Sec. 351). However, the basis for taxability under that section as considered by the trial court is the same as the basis for taxability under Section 811(a) invoked by the Government in this case. So the only difference between the *Waechter* appeal and the appeal in this case is that the Government is now contesting the same conclusion of law which it accepted in the *Waechter* appeal as to the deceased's wife's interest upon her death in a policy of insurance covering her surviving husband's life.

There has intervened between the time of the *Waechter* appeal and the present time the decision of the U. S. District Court (S.D. California Central Div.) in *California Trust Company v. Riddell*, 136 F. Supp. 7. In that case the Court without any reference whatever to the *Waechter* case merely concluded that since the wife had a community interest in a policy on her husband's life the Government was correct in including one-half the cash surrender value of that policy in her gross estate. Judge Hamlin, in this proceeding, after referring to the *California Trust Co.* case, then referred to the *Waechter* case and stated, "I am more persuaded by the reasoning of the trial court in this case (*Waechter*) and by the fact that that decision was upheld by the Court of Appeals."

In the case of *Mayr v. Arana* (1955), 133 C.A. (2d) 471, 284 P. (2d) 21 (District Court of Appeals, Sec-

ond District, Division 2, Calif.), under a policy insuring the husband's life the proceeds payable on his death were to be paid first to his wife as primary beneficiary, with any unpaid balance to be paid upon her death to his mother as secondary beneficiary. The husband died and a few hours after his death the wife died. The husband's mother claimed the proceeds as secondary beneficiary. The wife's parents claimed the proceeds as her heirs. The Court decided that under the policy the balance of the proceeds were payable upon death of the wife to the secondary beneficiary, and the Court then considered the question, "In view of the fact that the premiums on the insurance policy were paid with community funds, did the estate of decedent's wife have a community interest in the proceeds of the insurance policy". The Court's decision on this question was as follows:

"This question must be answered in the negative for two reasons:

(1) While it is true that under the California decisions the husband cannot make a gift of community property without his wife's consent, it is likewise settled that unless the wife desires to void the gift and takes action to set it aside the gift is valid. (*Blethen v. Pacific Mut. Life Ins. Co.*, 198 Cal. 91, 101 (7), 243 P. 431; *Pomper v. Behnke*, 97 Cal.App. 628, 638 (12, 13), 276 P. 122.)

In the instant case the foregoing rule is applicable since the wife, knowing the terms of the policy, never at any time took any steps to assert her community rights thereunder. On the contrary, the record discloses that the agent who

sold the policy testified that Mrs. Ramona Arana stated at the time the policy was issued that she felt the proceeds, if she were not living, should go to the decedent's mother. Since the wife took no steps to invalidate the gift, assuming it to be such, prior to her death, it became valid upon her death. (*Italian American Bank v. Canepa*, 52 Cal.App. 619, 621 (1), 199 P.55.)

(2) There was not a gift of the proceeds of the policy to respondent since the decedent could have given one half of the proceeds to his mother without his wife's consent, but in consideration of the wife's consenting to the policy whereby she became the primary beneficiary of the entire amount named in the policy she released her community interest, in the event of her death prior to her mother-in-law's, to respondent. (Cf. *Trimble v. Trimble*, 219 Cal. 340, 343 (4), 26 P.2d 477.)" 133 C.A. (2d) at 477-478.

In its brief the Appellant has consistently confused the right of a surviving wife in the *proceeds* of life insurance on her deceased husband's life, with the right of a wife at time of her death in insurance policies covering the life of her living husband. These are separate and distinct rights covering separate and distinct property. The particular issue under discussion here does not involve *proceeds* of the policies on the husband's life—he is still living; it involves only the right of the wife at the time of her death in an insurance *policy contract* insuring the life of her surviving husband.

Appellee concedes that if the husband had died first and the policy proceeds had been paid to Mrs. Stew-

art, she would have received them as her separate property, one-half traceable to her own share of community property and one-half traceable to her husband's share of community property. This result follows because at her husband's death the proceeds, as property, came into existence, and a previously existing contingent or inchoate gift became complete and vested. (*In re Miller Estate* (1937) 23 Cal. App. (2d) 16, 71 P. (2d) 1117.) In this case, however, the issue does not involve proceeds of a policy but involves the wife's community property interest at time of her death in the policy or contract which provides for a contingent inchoate gift whether the gift be to her or to a third person, or both.¹

The only rights which the wife possessed in these contracts at the time of her death were (A) where she is named beneficiary, a right contingent upon her surviving her husband to acquire the proceeds (*Mayr v. Arana, supra*), and, (B) where a third party is named beneficiary, a right to object to the vesting of one-half of the completed gift *after* the death of her husband (*Blethen v. Pacific Mutual Life Ins. Co.*, 198 Cal. 91, 243 P. 431). She alone had that right of objection which she could exercise or not as she might elect, and if she failed to exercise that right the com-

¹Where the insured has not reserved the right to change beneficiaries, the named beneficiary has a vested right to obtain the proceeds upon the death of the insured, *contingent* upon surviving the insured; where the insured has reserved the right to change beneficiaries, the named beneficiary's interest prior to the death of the insured is that of a mere expectancy of an incomplete gift (*In re Castagnola's Estate*, 68 C.A. 732, 736, 230 P. 188 (1924)).

pleted gift to the third party beneficiary was valid immediately upon its vesting at time of husband's death. This right of protection, or this right to object, was personal and could not be exercised by her representatives or heirs after her death.² Upon her death this right merely ceased to exist—it was not transferred, nor did her death generate the transfer of any property. She had a right if she lived to cause a transfer of property to be made either by exercise or non-exercise of this right to object, but upon her death before the property represented by the proceeds came into existence, her right to exercise some future dominion over that property merely ceased or terminated. There was nothing identifiable over which she had the power of control under the policy at time of her death which was transferred upon her death. As the Court below concluded, her “right of protection did not enure to the benefit of anyone on her death since her death extinguished this right” (Tr. 49).

These community property rights of the wife in an insurance policy covering the life of her husband is something akin to a life estate in property terminating upon her death, or to a right as a joint tenant. Upon her death her right as owner of the half, or contingent owner of the whole became extinguished.

²Even the right to object to an outright gift of community property is personal to the wife.

“The right to avoid . . . is personal to the wife . . . it seems that if the wife dies during the lifetime of the husband without having taken steps to disaffirm the transaction, it becomes valid in its entirety.” 10 Cal. Jur. 2d, Community Property, Section 80.

As the right of a deceased joint tenant in joint tenancy property was not includible in his gross estate until special legislation was enacted to specifically include it, just so these community property rights of the wife contingent upon her surviving her husband, and extinguished upon her predeceasing her husband, cannot be included in her gross estate upon her death. This conclusion applies whether the wife be named beneficiary with or without her consent, or whether a third party be named beneficiary with or without her consent.

It is true that in cases of divorce or in cases involving wrongful death caused by a spouse beneficiary, the cash surrender value of a policy is recognized as a measure of community property in determining property rights of the husband and wife at a given time. But at no time did the wife have the right to compel the husband to cancel the insurance policy or demand or secure the cash surrender value of the policy.³ Under Section 172 of the California Civil Code the husband is made the manager of the community personalty. He had the exclusive right to use it as he saw fit excepting only that he could not make a gift of it without the consent of his wife. As the Court below pointed out (Tr. 49), "both before and after her death he (husband) had the right to take the cash surrender value of these policies without her

³The "cash surrender value" means the cash value, ascertainable by established rules, of a contract of insurance which has been abandoned and given up for cancellation to the insurer by the person having the contract right so to do. *In re Knight's Estate, supra*. Husband could not be compelled to cancel the contract. *Waechter—Dist. Ct.*, 98 F. Supp. at 962.

consent, because he had the management and control of the community property. It was only the dissipation of the cash surrender value during her lifetime by way of gift which she could prevent." Upon her death, therefore, she had no interest in the cash surrender value which was transferred or transferable.⁴ The insurance contract was not changed by her death and rights under this contract are determined by the law of contracts and not the law of succession (*Turner v. Metropolitan Life Ins. Co.*, 56 Cal. App. (2d) 862, 133 P. (2d) 859; beneficiaries take by contract and not by succession; *In re Estate of Ward*, 127 Cal. App. 347, 15 P. (2d) 901). Once the contract was entered into, her community property rights in the money used to pay the premiums changed from an absolute right to that money to those rights in the insurance contract herein described and those rights were rights which expired upon her death where she predeceased her insured husband. She had no right to dispose of the cash surrender value by will or otherwise and the California laws make no provision for collection by her personal representatives of any part of this cash surrender value.

On page 24 of its brief the Government argues that, "Because of her death, she ceased to hold an interest

⁴The estate tax is a tax on the *transfer* of the net estate (Section 810, Internal Revenue Code of 1939), and the net estate includes the value at time of death of all property to the extent of the decedent's interest therein, and the value of certain other property as particularly specified in the Code (Section 811). Unless there is an actual transfer upon death or a transfer specifically described by the Statute, there can be no federal estate tax.

in the policies, and such interest passed to her estate, to her husband, or to the beneficiaries of the policies''. There was no more a "passing" of property in this situation than in the situation of a deceased life tenant or a deceased joint tenant. The interest of the survivors existed by virtue of the original acquisition which created the life tenancy or the joint tenancy and not by virtue of any passing of property from the deceased life tenant or joint tenant. In this case, upon the death of the wife her interest merely expired and the interest of the survivors existed by virtue of the terms of the insurance contract and not by virtue of any passing of property from the deceased.

On page 25 of its brief the Government argues that if the husband, by naming a beneficiary, made a gift, the wife could avoid it, and when she did not avoid it her failure to do so caused a transfer of property upon her death. The fallacy of this argument is, first, that her right to avoid the gift, assuming there was a gift, was contingent upon her surviving her husband; and second, as to 17 of the 26 policies she was the primary beneficiary. Thus, there either was no gift by the husband of her property or, under the rule of law stated in the *Mayr v. Arana* case, *supra*, she gave up her community interest for an adequate consideration which was a right to receive *all* the proceeds contingent upon her surviving her husband.

As to 17 of the 26 policies, Mrs. Stewart expressed her assent in one way or another to the designation of herself as primary beneficiary and others as con-

tingent beneficiaries. In the *Ettlinger v. Connecticut General Life Insurance Company* case, 175 Fed. (2d) 870, a wife claimed an interest in proceeds of an insurance policy on her husband's life under which his children were designated as beneficiary, to which designation she had given her assent in writing. This Court, in denying the wife's claim, held that "an unqualified assent that the proceeds of the policies be paid to the designated beneficiary is a sufficient consent in writing that the wife gives up her community interest in the policy". This decision means nothing more than that the wife by her assent has given up her right to object after the death of her husband to the payment of the proceeds of the policy to a third party beneficiary.

No matter how this problem is analyzed we come back to the fundamental premise that the wife's community property interest in the insurance contract is merely the right to object to a payment of the proceeds to a third party beneficiary which right is contingent upon her surviving her husband; or it is a right to secure the proceeds of the policy where she is named beneficiary, but again contingent upon her surviving her husband and contingent also upon her designation as beneficiary not being revoked. Where she dies before her husband these community property rights of protection die with her. The rights of all other persons have been and are established under the contract and there is no passing or transfer of any property interest in the policies resulting from, or effective upon her death, and therefore no transfer

which would be subject to the taxing provisions of the Federal Estate Tax laws.

It is respectfully submitted that the decision and judgment of the District Court with respect to this issue is correct and should be affirmed.

II.

THE ANNUITY CONTRACTS OF THE WIFE, TO WHICH HER HUSBAND EXPRESSED HIS ASSENT, INVOLVED THE DEPOSIT AND DISPOSITION OF COMMUNITY PROPERTY WHICH REMAINED COMMUNITY PROPERTY UNTIL THE DEATH OF THE WIFE, EXCEPTING AS TO THE FIDELITY POLICIES WITH RESPECT TO WHICH THE HUSBAND SPECIFICALLY TRANSFERRED HIS COMMUNITY INTEREST TO HIS WIFE, SO THE ONLY AMOUNTS INCLUDIBLE IN HER GROSS ESTATE WITH RESPECT TO THESE POLICIES IS ONE-HALF THE VALUE OF THE PROCEEDS PAYABLE UNDER ALL POLICIES EXCEPT THE FIDELITY POLICIES, AND THE ENTIRE VALUE OF THE PROCEEDS PAYABLE UNDER THE FIDELITY POLICIES.

The Government contends that the value of annuities payable after her death to beneficiaries named under seven annuity policies which were issued to the decedent in 1934 or 1935, should be included in full in the estate of the decedent, notwithstanding premiums which were paid for these policies were paid out of community funds. The Government contends that the decedent's interest in the annuities was acquired by her as her separate property because she had acquired her right thereunder by an instrument in writing, and under Section 164 of the Civil Code of California there is a presumption that any prop-

erty acquired by a married woman by an instrument in writing is her separate property. The Government also contends that, "Although it is felt that under the California law these policies have been the separate property of decedent ever since they were first issued to her, should the Court for some reason reach a contrary decision . . . the policies became separate property of the decedent at the time her husband signed the change of beneficiary forms", and in support of this contention the Government cites the case of *Ettlinger v. Connecticut General Life Insurance Company*, 175 Fed. (2d) 870.

The taxpayer contends that the annuities and the right to annuities were community property and therefore only one-half of the value of the beneficiary's right to receive the annuities after the wife's death is includible in her gross estate for federal estate tax purposes, excepting as to the annuities under the Fidelity policies which are conceded to be her separate property.

The Court below concluded:

"It was stipulated that the policies were procured after the marriage and premiums were paid with community funds. Under California law the policies were, prima facie, community property. *Grimm v. Grimm* (1945), 26 C.2d 173, 157 P.2d 841. . . .

"There are a number of ways by which these policies could become the separate property of Mrs. Stewart, but the only plausible explanation according to the facts as they existed is that they became such, if at all, by gift from Mr. Stewart

to Mrs. Stewart. Indeed, that is what the Government contends occurred.

“However, there is no substantial evidence in the record before me that there was such a gift, except as to the Fidelity policies; in fact, all the evidence is to the contrary. When Mrs. Stewart requested the insurance companies to change beneficiaries or mode of settlement, Mr. Stewart concurred in writing a majority of the time. His consent to these changes would not be necessary if the policies were Mrs. Stewart’s separate property. As stated above, in 1950 Mr. Stewart signed a document whereby he very definitely relinquished his community property rights in the Fidelity policies. As to those policies there is no doubt that they were Mrs. Stewart’s separate property at the time of her death, but the fact that he saw fit not to do the same thing with his interest in the other policies is strong evidence that he did not intend to make a gift of them, but rather intended to retain his community interest.” (Tr. p. 40-41.)

The Court thereafter pointed out that just before her death Mrs. Stewart arranged for monthly payments to herself of a certain amount for a definite period while she lived, and to her daughter in the event of her death prior to the expiration of the designated period, and the Court concluded:

“This right to receive the monthly payments was an interest in property which the decedent owned at the time of her death and is includible in her estate under Sec. 811(a). However, the monthly payments she did receive prior to her death, and, therefore, the right to receive those

payments, was a community asset. Mrs. Stewart's interest in the payment and the right to payment was only one-half thereof because of the operation of the community property laws. Therefore, one-half of the proceeds would be included in her estate.

"The proceeds of the Fidelity policies would be an exception to this rule. As was mentioned earlier, Mr. Stewart relinquished his community property rights in those policies prior to Mrs. Stewart's death and they thus became her separate property. As her separate property all the proceeds would be included in her gross estate." (Tr. p. 43-44.)

The Government argues that the presumption that property acquired by the wife in her own name is separate property is "evidence", that although the presumption is rebuttable there was no evidence to rebut it, and therefore the conclusion of the Court was contrary to the evidence (Appellant's Brief, p. 29). The presumption that property acquired during marriage is community property is also "evidence", and the presumption that property acquired with community funds continues to be community property is also "evidence", and the stipulation that the premiums paid for the annuities were paid out of community funds is also "evidence", and the inference of community property arising from the requirement of the insurance companies that Mr. Stewart express his assent is also "evidence", and further the fact that the husband executed a specific assignment of his rights in the Fidelity contracts to his wife as her

separate property and did not do so with respect to the other contracts is also "evidence". The Court below considered all of this evidence, and its finding that the evidence establishes that there was no gift from the husband to the wife, excepting as to the Fidelity policies, is binding upon appeal. (Rule 52(a), Federal Rules of Civil Procedure; *Rollingwood Corp. v. Commissioner* (1951-CA-9), 190 F. (2d) 263—notwithstanding facts were stipulated.)

Prudential Insurance Company v. Harrison, 106 Fed. Supp. 419 ((1952) SD-Central Division, California), involved a situation where a husband convicted of manslaughter for killing his wife made a claim as a beneficiary named in an insurance policy issued to his wife on her life, the premiums for which policy had been paid with community property. The Court after discussing separate property and community property held that the policy and the proceeds thereof were community property and not separate property of the wife, and therefore half the proceeds belonged to the husband as his part of the community. The Court concluded also that the husband could not collect the other part of the proceeds because of the statute preventing him from gaining from his own wrongdoing. In holding that the policies and the proceeds were community property the Court emphasized, "Community property is the rule, separate property the exception thereto", and the Court thereupon cited DeFuniak's "Principles of Community Property 1943", stating, "It is usually considered by most courts that, when a spouse dur-

ing marriage, takes out a policy on his or her own life and the premiums are paid from community funds, the policy represents community property”.

In the case of *Union Mutual Life Insurance Company v. Broderick*, 196 Cal. 497, 238 Pac. 1034 (1925), a husband named his sister in place of his wife as a beneficiary under an insurance policy purchased with community funds in consideration for his sister making him two loans of \$1,000, and other consideration, and the question arose as to whether the husband had made a gift of the policy to his wife prior to the naming of his sister as beneficiary. The trial court found that there was no gift and the Appellate Court held that the finding that the husband did not make a gift of the policy to the wife was controlling on appeal.

Acceptance by this Court of the lower Court's findings would alone require affirmance of the decision of the Court below. But Appellant's interpretation of Section 164 of the Civil Code of California seems to be so far at variance with the true meaning and effect of that Section that some comment thereon is required.

Section 164 of the Civil Code provides first:

“All other property acquired after marriage by either husband or wife, or both, including real property situated in this State . . . is community property.”

In this case Mr. and Mrs. Stewart gave a sum of money to an insurance company who contracted with Mrs. Stewart to pay annuities to her, or to her named

beneficiaries, the first of whom was her husband. It is stipulated that the money paid to the insurance company was community property (Stip. para. 15, Tr. 28). The presumption arises immediately that the annuities and the right to annuities attributable to the investment of the community funds in the annuity contract is community property.

Section 164 continues:

“but whenever any real estate or personal property or any interest therein or encumbrance thereon, is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property . . .”

In this case Mr. and Mrs. Stewart delivered community funds to the insurance company who contracted with Mrs. Stewart to in effect return it in the form of annuities at her direction. Is this “personal property . . . acquired by a married woman by an instrument in writing” within the meaning of Section 164? The presumption of separate property established by Section 164 does not apply to instruments which do not actually convey a *title in property*. (*Pacific Tel. & Tel. Co. v. Wellman*, 98 C.A. (2d) 151, 219 P. (2d) 506 (1950); *Estate of Inman*, 148 A.C.A. 975, 307 P. (2d) 953 (1957).) The contract between Mrs. Stewart and the insurance company was merely an arrangement for *disposition* of community property deposited with the company by Mr. and Mrs. Stewart. Mrs. Stewart might have directed the company to return the money to her and in that event the money would still be community

property. It is difficult to see how this contract can be construed as conveying title to property to Mrs. Stewart.

Section 164 continues:

“... except; that when any of such property is acquired by husband and wife by an instrument in which they are described as husband and wife, unless a different intention is expressed in the instrument, the presumption is that such property is the community property of said husband and wife.”

All of the contracts with the insurance company specifically describe Mr. and Mrs. Stewart as husband and wife. There is nothing in the contracts indicating any intention that something was to be acquired as the separate property of Mrs. Stewart; to the contrary, the contract indicates a joint endeavor to *dispose* of community property in a specific way. It is also significant that Mr. Stewart was required to express his assent or authorization to change of beneficiaries in all of the policies, indicating quite clearly that the insurance companies did not look upon Mrs. Stewart's rights as her separate property. If they had thought her interests were her separate property they could have relied upon the final sentence in Section 164 which provides:

“The presumptions in this section mentioned are conclusive in favor of any person dealing in good faith and for a valuable consideration with such married woman or her legal representatives or successors in interest, and regardless of any change in her marital status after acquisition of said property.”

The insurance companies must have recognized the community property character of the money paid to them as premiums for the contracts. It is stipulated herein that the money so used was community property, and that Mr. Stewart, as Executor of Mrs. Stewart's estate, reported the value of the annuities in the federal estate tax returns as community property (Stip. para. 15, Tr. 28). The Court below was correct in concluding that the value of the annuities was community property and that there is nothing in the evidence to justify a contrary conclusion.

The foregoing argument establishing that the annuity contracts represented nothing more than a contract for a deposit and disposition of community property, the interest therein at all times continuing to be community property, refutes not only the Government's contention that the right to annuities was the separate property of the wife under Section 164 of the California Civil Code, but also the Government's alternative contention that the husband's assent to the execution of the policy constituted a gift to his wife of the community property deposited with the insurance company. However, since the Government refers to the *Ettlinger* case, supra, in support of this alternative contention, a discussion of this case would seem necessary.

The *Ettlinger* case involved a claim by a wife of part of the proceeds under an insurance policy covering the life of her deceased husband, which proceeds were payable to children who were named by the husband as beneficiaries under the policy, and whose

designation of beneficiary was assented to by the wife. The Court held that there was no other reason for the expression of consent by the wife except to record her agreement relinquishing her community property interest in the policy. The case is not applicable to the issue here involved. The case involves the right of a wife in proceeds under life insurance policies, and not the right of a husband in annuity contracts, premiums for which were paid out of community funds; and the case involves the effect of a consent by the wife to the payment of proceeds to a beneficiary designated by the husband; and not the effect of a consent by the husband to his wife's contract. The *Ettlinger* case involved a contract made by the husband which was valid without the consent of his wife; whereas here there is involved a contract made by the wife which would have been invalid and void without the consent of the husband.

As has hereinbefore been pointed out, it is stipulated in this case that the deposit of money with the insurance companies as premiums for the annuity policies, was a deposit of community funds. The insurance companies required an expression of assent by Mr. Stewart as shown by the policies or policy endorsements (See *supra*, p. 23). This expression of assent, excepting as to the Fidelity policies, was not in any sense a transfer of property but was nothing more than an authorization by Mr. Stewart that Mrs. Stewart, as his agent or as agent for the community, could contract with respect to the community property. Without this authorization the contract would

have been invalid and void because under Section 172 of the California Civil Code the husband has exclusive management and control of the community property. Under this section the wife has no power to dispose of the community property, or to enter into contracts for the sale and exchange thereof. *La Rosa v. Glaze*, 18 C.A. (2d) 354, 63 P. (2d) 1181 (1936); *Newell v. Brawner*, 140 C.A. (2d) 523, 295 P. (2d) 460 (1956). In the *La Rosa* case, the Court states:

“The evidence is undisputed that . . . the subject of this litigation was the community property of Mr. and Mrs. Glaze. The husband, therefore, had the management and control of the property (Secs. 161a and 172 Civ. Code; 13 Cal. Jur. 819, Sec. 25). The evidence is also uncontradicted that the wife was not authorized by her husband, either as his *agent* or otherwise, to sign the contract . . . Nor is there any evidence that he thereafter ratified the contract. *The purported contract was therefore unauthorized and void.*” (Emphasis added.) 18 C.A. (2d) at 357.

In the *Newell* case, the Court states:

“The bill of sale executed by the wife was ineffective to convey title to the community property, or any part of it, to defendant. (Civ. Code para. 172.) 140 C.A. (2d) at 526.”

The validity of these insurance policies contracted for by the wife as the insured for the deposit of a premium paid from community funds, must depend upon an appointment by or an authorization from her husband to act as his agent. Whatever rights were accorded the wife under these contracts must neces-

sarily have been rights exercisable by her only as agent for her husband or the community. In the *Ettlinger* case the Court pointed out that there was no reason for the wife to consent to a contract covering community personal property except to relinquish an interest therein; whereas in this case the husband's assent was essential as a delegation of authority to his wife to act as his agent to preserve the validity of the contract. Had the subject of the contract been the separate property of the wife his assent would not have been necessary.

The record in this case clearly supports the conclusion of the Court below that the subject matter of the annuity contracts involved community property and continued to be community property up to the time of death of the wife, excepting as to the Fidelity policies as to which the husband specifically transferred his community interest to his wife. The decision of the lower Court should be sustained.

CONCLUSION.

It is respectfully submitted that the Court below was correct in concluding (1) that but one-half the value of proceeds payable under annuity policies after the death of Mrs. Stewart are includible in her gross estate for federal estate tax purposes, excepting that as to the Fidelity policies the entire value of such proceeds are includible, and, (2) that no part of the cash surrender value or any other value of the insurance policies covering the life of her surviving

husband is includible in her gross estate, and the decision of the Court below should be affirmed.

Dated, San Francisco, California,
August 28, 1958.

Respectfully submitted,

GEORGE H. KOSTER,

Attorney for the Appellee.

Of Counsel:

RICHARD W. GRAHAM.

(Appendix Follows.)

Appendix.



Appendix

Civil Code of California:

Sec. 161a. *Community property; interests of parties defined.*

The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property (Added Stats. 1927, c. 265, p. 484, Sec. 1.)

Sec. 162. *Separate property; wife.*

SEPARATE PROPERTY OF THE WIFE. All property of the wife, owned by her before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof, is her separate property. The wife may, without the consent of her husband, convey her separate property. (Enacted 1872)

Sec. 164. *Community property; presumptions as to property acquired by wife; limitation of actions.*

All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in

this State, is community property; but whenever any real or personal property, or any interest therein or encumbrance thereon, is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property, and if acquired by such married woman and any other person the presumption is that she takes the part acquired by her, as tenant in common, unless a different intention is expressed in the instrument; except, that when any of such property is acquired by husband and wife by an instrument in which they are described as husband and wife, unless a different intention is expressed in the instrument, the presumption is that such property is the community property of said husband and wife. The presumptions in this section mentioned are conclusive in favor of any person dealing in good faith and for a valuable consideration with such married woman or her legal representatives or successors in interest, and regardless of any change in her marital status after acquisition of said property.

* * * (Enacted 1872. As amended Stats. 1889, c. 219, p. 328, Sec. 1; Stats. 1893, c. 62, p. 71, Sec. 1; Stats. 1897, c. 72, p. 63, Sec. 1; Stats. 1917, c. 581, p. 827, Sec. 1; Stats. 1923, c. 360, p. 746, Sec. 1; Stats. 1927, c. 487, p. 826, Sec. 1; Stats. 1935, c. 707, p. 1912, Sec. 1; Stats. 1941, c. 455, p. 1752, Sec. 1.)

Sec. 172. *Community personal property; management and control; restrictions on disposition.*

The husband has the management and control of the community personal property, with like absolute

power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such community personal property, or dispose of the same without a valuable consideration, or sell, convey, or encumber the furniture, furnishings, or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife. (Enacted 1872. As amended Stats. 1891, c. 220, p. 425, Sec. 1; Stats. 1901, c. 190, p. 598, Sec. 1; Stats. 1917, c. 583, p. 829, Sec. 1.)

Probate Code of California:

Sec. 201. *Title of surviving spouse; portion subject to testamentary disposition or succession.*

Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse subject to the provisions of sections 202 and 203 of this code. (Stats. 1931, c. 281, p. 595, Sec. 201, as amended Stats. 1935, c. 831, p. 2249, Sec. 2.)

Internal Revenue Code of 1939

Sec. 810. *Rate of Tax.*

A tax equal to the sum of the following percentages of the value of the net estate (determined as provided in section 812) shall be imposed upon the transfer of the net estate of every decedent, citizen or resident of

the United States, dying after the date of the enactment of this title. . . .

Sec. 811. *Gross Estate.*

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

(a) Decedent's Interest.—To the extent of the interest therein of the decedent at the time of his death;

* * *

(c) Transfers in Contemplation of, or Taking Effect at, Death.—

(1) General Rule.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

(A) in contemplation of his death; or

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

(C) intended to take effect in possession or enjoyment at or after his death.

(2) Transfers Taking Effect at Death.—Transfers prior to October 8, 1949.—An interest in property of which the decedent made a transfer, on or about October 7, 1949, intended to take effect in possession or enjoyment at or after his death shall not be included in his gross estate under paragraph (1) (C) of this subsection unless the decedent has retained a reversionary interest in the property, arising by the express terms of the instrument of transfer and not by operation of law, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 per centum of the value of such property. For the purpose of this paragraph, the term “reversionary interest” includes a possibility that property transferred by the decedent (A) may return to him or his estate, or (B) may be subject to a power of disposition by him, but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent’s death) by usual methods of evaluation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Commissioner with the approval of the Secretary.

In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate.

(3) Transfers Taking Effect at Death—Transfers After October 7, 1949.—An interest in property transferred by the decedent after October 7, 1949, shall be included in his gross estate under paragraph (1)(C) of this subsection (whether or not the decedent retained any right or interest in the property transferred) if and only if—

(A) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent; or

(B) under alternative contingencies provided by the terms of the transfer, possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the earlier to occur of (i) the decedent's death or (ii) some other event; and such other event did not in fact occur during the decedent's life.

Notwithstanding the foregoing sentence, an interest so transferred shall not be included in the decedent's gross estate under paragraph (1)(C) of this subsection if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a power of appointment (as defined in Section 811(f)(2)) which in fact was exercisable immediately prior to the decedent's death.

(d) Revocable Transfers.—

(1) Transfers after June 22, 1936.—To the extent of any interest therein of which the decedent has at

any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death;

(2) Transfers on or Prior to June 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph;

(3) Date of Existence of Power.—For the purposes of this subsection the power to alter, amend, or revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even

though the alteration, amendment, or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

* * *

(g) Proceeds of Life Insurance.—

(1) Receivable by the Executor.—To the extent of the amount receivable by the executor as insurance under policies upon the life of the decedent.

(2) Receivable by Other Beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For the purposes of clause (A) of this paragraph, if the decedent transferred, by assignment or otherwise, a policy of insurance, the

amount paid directly or indirectly by the decedent shall be reduced by an amount which bears the same ratio to the amount paid directly or indirectly by the decedent as the consideration in money or money's worth received by the decedent for the transfer bears to the value of the policy at the time of the transfer. For the purposes of clause (B) of this paragraph, the term "incident of ownership" does not include a reversionary interest.

(3) Transfer Not a Gift.—The amount receivable under a policy of insurance transferred, by assignment or otherwise, by the decedent shall not be includible under paragraph (2)(A) if the transfer did not constitute a gift, in whole or in part, under Chapter 4, or, in case the transfer was made at a time when Chapter 4 was not in effect, would not have constituted a gift, in whole or in part, under such chapter had it been in effect at such time.

* * *

(26 U.S.C., 1952 ed., Secs. 810, 811)



No. 16,014

IN THE

United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

VS.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,
Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

REPLY BRIEF FOR THE APPELLANT.

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ROBERT H. SCHNACKE,

United States Attorney.

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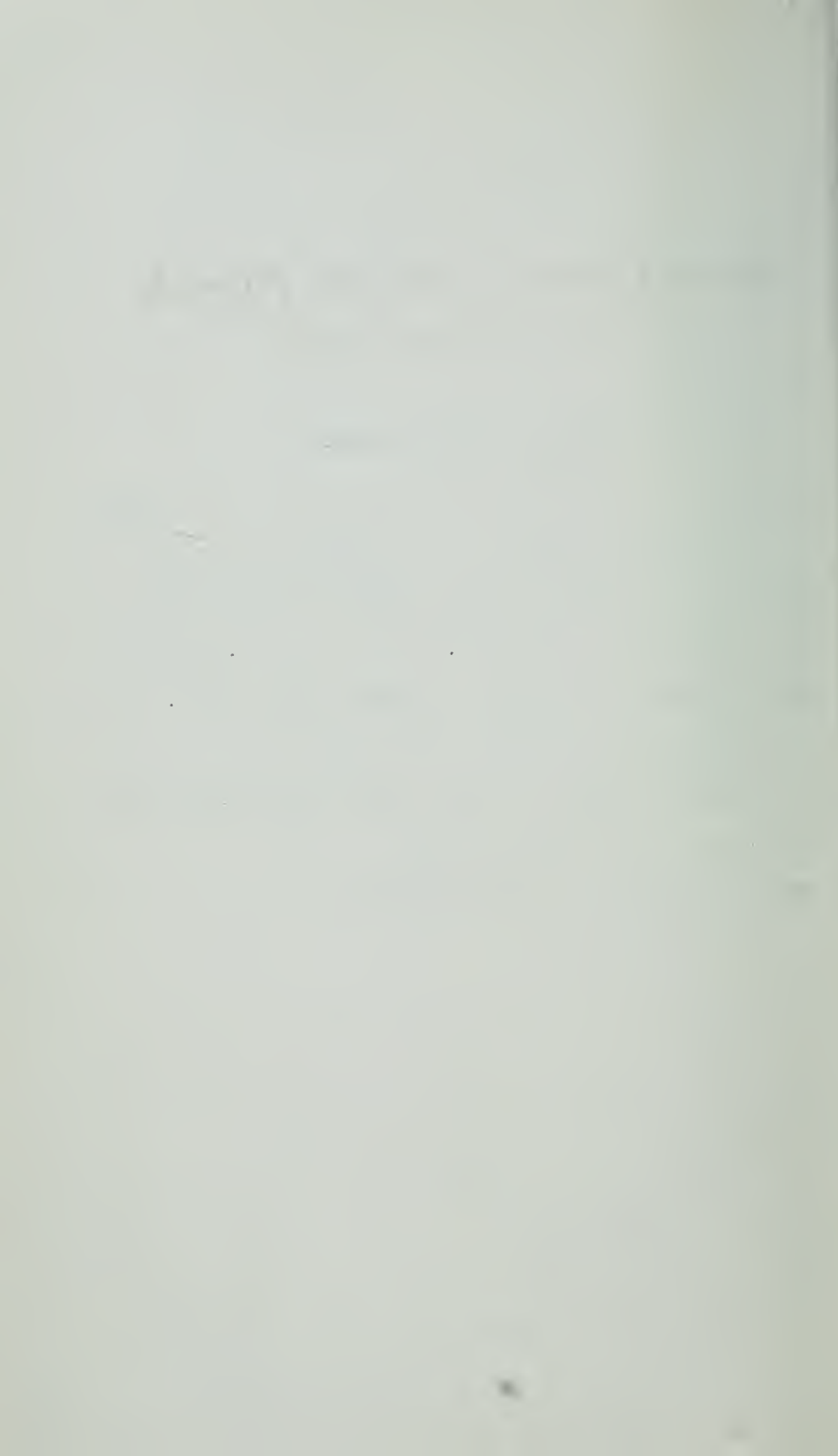
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PAUL P. O'BRIEN, CLERK



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No. 16,014

IN THE

**United States Court of Appeals
For the Ninth Circuit**

UNITED STATES OF AMERICA,

Appellant,

vs.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,

Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

REPLY BRIEF FOR THE APPELLANT.

This reply brief is directed solely to the question of the includibility in the decedent's estate of one-half the cash surrender value of community property life insurance policies on her husband's life. Since the Government's opening brief in this case was prepared, the Supreme Court of Washington, sitting *en banc*, has held that its decision in *In re Knight's Estate*, 31 Wash. 2d 813, 199 P. 2d 89, was incorrect in holding that the cash surrender value of a life insurance

policy is not property which passes by will or by the statute of inheritance. *In re Leuthold's Estate*, Wash. 2d, 324 P. 2d 1103,¹ held that one-half of the cash surrender value of straight line insurance policies on the life of a surviving husband, premiums of which were paid out of community funds, were passed upon the death of the wife to her legatees, and therefore such value was taxable.

Because one of the decisions concerning federal income taxes, the District Court decision in the case of *Waechter v. United States*, 98 F. Supp. 960 (W.D. Wash.), is based upon the decision of *In re Knight's Estate*, and because the lower court in the case at bar has relied upon the *Waechter* case, we are setting forth some of the language of the *Leuthold* case (324 P. 2d 1103, 1106-1107):

The situation in the present case is no different than if Mr. Leuthold had taken community funds and opened a savings account with a bank in his own name. Assume, further, that at the time of his wife's death the balance in the savings account was approximately the same amount as the total cash surrender values involved in this case. Of course, it would not be contended that the wife's community one-half interest in the bank account would not be taxable on her death whether the husband had or had not exercised his right of withdrawal of the deposit at that time.

* * * * *

¹Petition for rehearing is pending in this matter. 50 Wash. 2d 869.

The precise question before us was recently decided by the court of civil appeals of Texas in *Thompson v. Calvert*, Tex. Civ. App., 301 S.W. 2d 496, 498. On a stipulation of facts substantially identical with those shown by the record in this case, the Texas court sustained the taxability, for inheritance tax purposes, of half of the cash value of life insurance policies on the husband's life when his wife predeceased him.²

In both *Thompson v. Calvert*, 301 S.W. 2d 496, and *In re Leuthold's Estate*, *supra*, the District Court opinion in *California Trust Co. v. Riddell*, 136 F. Supp. 7 (S.D. Cal.), was quoted with approval. The court in the *Leuthold* case likewise cited with approval *Estate of Carroll v. Commissioner*, 29 B.T.A. 11, where in a very similar situation one-half of the cash surrender value of life insurance policies on the surviving husband's life were included in the taxable estate of a Louisiana decedent. Both of these cases are discussed in our main brief. It is apparent that the Supreme Court of Washington has recognized that the husband may not, by the purchase of life insurance on his own life, defeat the wife's interest in

²The decision in *Thompson v. Calvert*, 301 S.W. 2d 496, is particularly interesting due to the fact that in Texas the wife has no right to proceeds of life insurance on her husband's life purchased with community property funds even though she has not acquiesced in such purchase. This is so because in Texas, unlike California, the husband can give away the community property in the absence of fraud. For a complete discussion of the community property nature of life insurance in the State of Texas, see the recent decision in *Commissioner v. Chase Nat. Bk. of N.Y., Tr.* (C.A. 5th), decided August 19, 1958 (52-2 U.S.T.C., par. 11,818, pp. 8076-8083).

the community property funds which were used to purchase such policies. The decision of the court below was incorrect and should be reversed.

Respectfully submitted,

CHARLES K. RICE,

Assistant Attorney General.

LEE A. JACKSON,

HELEN A. BUCKLEY,

Attorneys, Department of Justice,

Washington 25, D. C.

ROBERT H. SCHNACKE,

United States Attorney.

September, 1958.

No. 16,014

IN THE

United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

ASHBY O. STEWART, Executor of the
Last Will and Testament of Mary
W. Stewart, Deceased,
Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

APPELLEE'S PETITION FOR A REHEARING.

GEORGE H. KOSTER,
300 Montgomery Street,
San Francisco 4, California,
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FILED
JUL - 7 1959
PAUL P. O'BRIEN, CLERK



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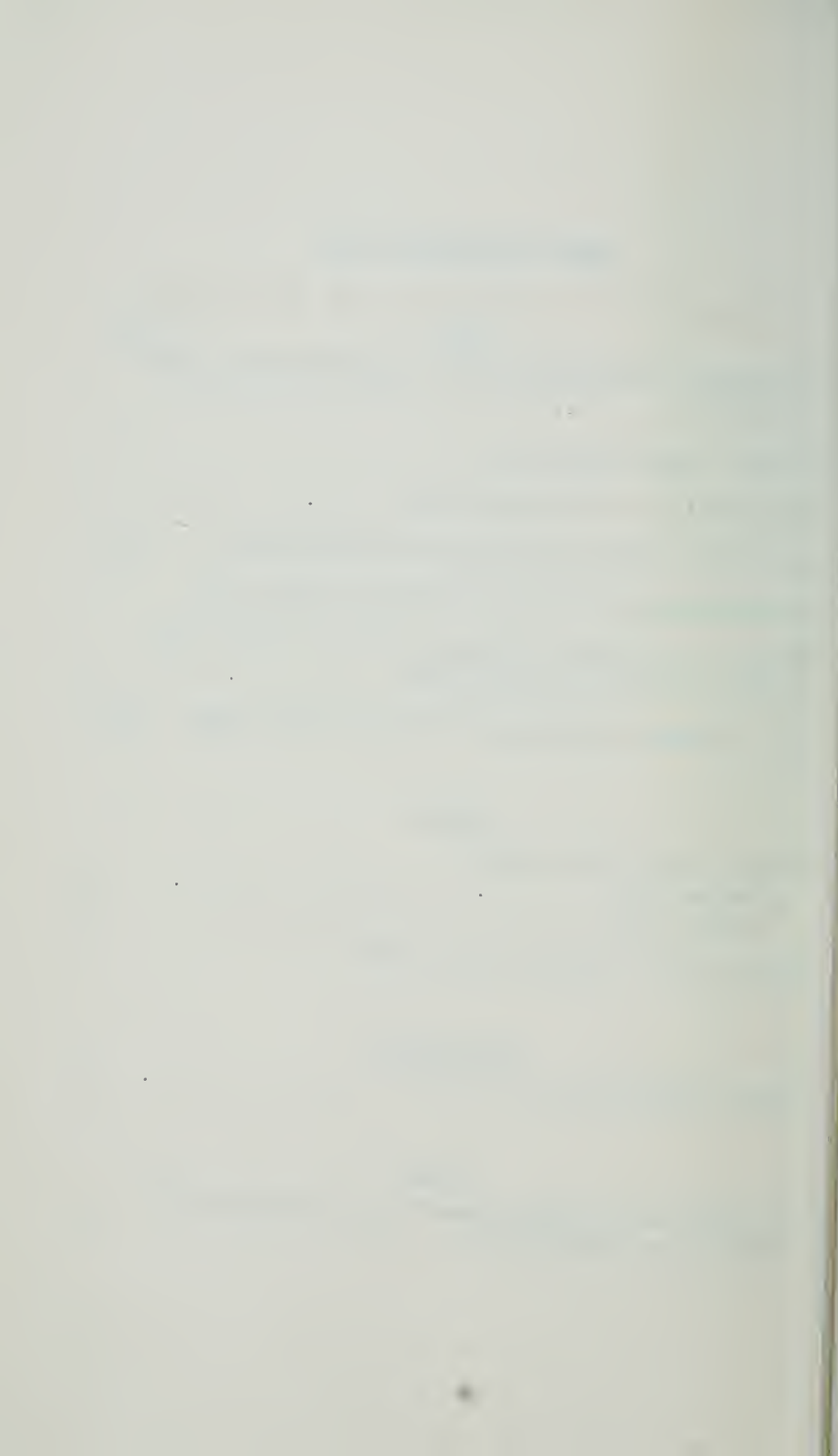
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No. 16,014

IN THE

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ASHBY O. STEWART, Executor of the
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W. Stewart, Deceased,
Appellee.

On Appeal from the Judgment of the United States District Court
for the Northern District of California.

APPELLEE'S PETITION FOR A REHEARING.

*To the Honorable Judges of the United States Court
of Appeals for the Ninth Circuit:*

Petitioner, Ashby O. Stewart, Executor of the Last Will and Testament of Mary W. Stewart, deceased, the plaintiff-appellee above named, presents this, his petition for rehearing in the above-entitled cause, and in support thereof respectfully shows:

This Court in its decision on the issue as to whether any part of the value of insurance policies on the life of the surviving husband should be included in the

decedent's estate for federal estate tax purposes, acknowledged that this question "is determined by the State law of community property" (Opinion, p. 2). There is no California law which specifically defines or describes the nature or quantum of the wife's interest or estate at the time of her death in life insurance policies on the life of her surviving husband. However, there is such law now in the making through the medium of the case of *Estate of Mendenhall*, No. 56225, recently decided by the Superior Court of the State of California in and for the County of San Diego, which the State Controller has announced will be appealed.

This Court appears to be of the opinion that because the *Mendenhall* case involves the California Inheritance Tax law and because of differences between the California Inheritance Tax law and the Federal Estate Tax law, the ultimate decision in the *Mendenhall* case could not affect its decision here (Footnote 5 on page 6 of Opinion). It is respectfully submitted that the disposition of the issue in the *Mendenhall* case and in this case depends upon the same essential determination of the nature and extent of the wife's rights under California law in the insurance policies covering the life of her surviving husband.

Obviously then, if this case should reach the stage of finality before the final determination in the *Mendenhall* case, irreparable damage could result to the Stewart estate in the imposition of a substantial amount of non-refundable federal estate tax which might not be due, in the event the California Courts

should determine in the *Mendenhall* case that the wife had no interest in those policies which could be *transferred by or upon her death*.

The State inheritance tax is a tax imposed upon the transfer of property and for the privilege of receiving the property by succession;¹ the Federal estate tax is an excise tax imposed upon the transfer of property, and is for the privilege of transferring property.² It is significant that both laws require as a condition to the imposition of a tax that there be a "transfer" of property specifically subjected to the tax.

In the *Mendenhall* case the wife died leaving her estate in trust for her children. The California Inheritance Tax Department concluded that part of the property transferred by the wife by that bequest was her interest in life insurance policies covering the life of her surviving husband, and the Department thereupon asserted a tax against the beneficiary for the right to receive that bequest. The Superior Court determined that the wife had no interest in those policies which could be transferred by her either by Will or under the laws of succession, and the Court therefore concluded that there was no transfer and there could therefore be no inheritance tax. The Court states on page 1 of its opinion:

¹Section 13401 of the Revenue Code of California: "An inheritance tax is hereby imposed upon every transfer subject to this part."

²Section 810 of the Internal Revenue Code of 1939: "A tax . . . shall be imposed upon the transfer of the net estate of every decedent citizen or resident of the United States dying after the date of the enactment of this title."

“It is the opinion of the Court that at the time of her death the testatrix . . . had no such interest in the life insurance policies upon the life of her husband . . . as would result in a taxable transfer upon her death. . . .”

The significance of this decision is that if it is true under the California law that no one could obtain any interest in the insurance policies by transfer as a result of the wife's death, either under her Will or under the laws of succession, then there is no transfer of property upon which the tax can be imposed, whether that tax be a California inheritance tax or a Federal estate tax. It is the insurance contract which is the generating force directing the transfer of whatever interests may exist in the insurance policies. The death of any person mentioned in the contract may ultimately determine the person to whom the policy values will be transferred, but the death does not generate or effect the transfer. This principle was specifically invoked by the trial Judge in the *Waechter* case³ in support of the conclusion that there could be no tax in the wife's estate with respect to the insur-

³In its decision in that case, at 98 F. Supp. 960, 962, the District Court said: “In the case of policies payable on the death of an insured, who is the surviving spouse, ‘nothing whatever became payable on the death of the beneficiary, the deceased wife’. In re *Knight's Estate*, *supra*, 31 Wash(2d) at page 941, 199 P.2d at page 94. The language just quoted was used in a case arising under the inheritance tax statute of the State of Washington. But the logic of the reasoning applies with equal force to the estate tax. To be taxable, a transfer of an estate must occur. And if, as it appears, the wife had no power to transfer one-half of her surrender value in the policy, and upon her death nothing became due to her heirs, there is no interest to which the estate tax would attach. . . .”

ance policies covering the life of the surviving husband.

This Court throughout its opinion emphasizes the fact that the wife had an interest in the policies during her lifetime, and it is primarily on the basis of this premise that the Court finds "accordingly that a substantial interest passed from the wife to the husband upon the wife's death with respect to all of the policies" (Opinion, p. 10). Unless the term "passing" is used synonymously with the term "transfer", neither the Federal estate tax nor the California inheritance tax would be applicable. This Court cited *Commissioner of Internal Revenue v. Clise* (CA 9, 1941) 122 F(2d) 998, 1001, calling attention to the statement therein concerning the Federal estate tax, that "It does not tax the interest to which the legatees and devisees succeed on death but the interest which ceased by reason of death; what is imposed is an excise upon the transfer of an estate upon death of the owner." (Opinion, p. 6).

The first clause of the quoted statement⁴ must be read in conjunction with the second clause, so that the reference to taxation of the interest which ceased by

⁴It would appear that in the case of *Commissioner v. Clise*, 122 F.2d 998, and other cases, the use of the clause that the taxing act taxes "not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death", was intended to explain that once having established a taxable transfer the tax applied to the value of the property which was the subject of the transfer at the time of death, rather than some other value based upon what the legatees received. *Edwards v. Slocum*, 246 U.S. 61. In the case of *Ithaca Trust Co. v. U.S.*, 279 U.S. 151, the Supreme Court touches upon this situation with the remark, "The tax is on the act of the testator not on the receipt

reason of death must contain the further requirement that the interest which ceased by reason of death must also be the subject of a transfer by reason of the death and generated by the death. If it were not so, then such interests as life interests which ceased by reason of death would be subject to tax, and yet there is no question but that there is no tax upon the estate of a life tenant by reason of the termination of the life tenancy, notwithstanding that the interest of the remainderman becomes enhanced upon the death of the life tenant.⁵ This is also true in the case of an interest which is contingent upon survival of a certain person or event, and no tax would be imposed upon that contingent interest if the person having it dies before the specified time, notwithstanding someone else has an interest which is immediately augmented by that death.⁶ A similar situation exists in the case of joint tenancies, with respect to which a specific section in the law was considered essential to impose the estate tax.⁷

We believe that the logic and legal theory upon which the decision of the Superior Court in the *Mendenhall* case is predicated is that upon her death, the wife's property rights under the insurance contracts

of property by the legatees. *Young Men's Christian Assn. v. Davis*, 264 U.S. 47; *Knowlton v. Moore*, 178 U.S. 41; and passim; *New York Trust Co. v. Eisner*, 256 U.S. 345, 348, 349; *Edwards v. Slocum*, 264 U.S. 61."

⁵*Rhodes v. Commissioner of Internal Revenue*, 41 B.T.A. 62, aff'd, (CA 8, 1941) 117 F(2d) 509.

⁶Regulations 80—Article 13.

⁷Internal Revenue Code of 1939, Sec. 811(e); see Beveridge, *Law of Federal Estate Taxation* (Callaghan & Co., 1956), Sec. 4.02, p. 129.

were not the subject of a disposition or transfer but merely terminated or expired, and that she had nothing over which she had the right to exercise a power of disposition or transfer upon her death.

The Superior Court follows the reasoning of the case of *In re Knight's Estate*, 31 Wash.(2d) 813, 199 P.(2d) 89, specifically preferring it to the later decision of the Washington Supreme Court in the case of *Leuthhold's Estate*, 50 Wash.(2d) 869, 324 P.(2d) 1103. If by affirmance by the appellate courts the *Mendenhall* case should become the law in California on this subject, then the decision of this Court in the case of *U. S. v. Waechter*, 159 F(2d) 963, aff'g. 98 F. Supp. 960, *would be directly applicable* and under authority of the *Waechter* case the imposition of the Federal estate tax against Mrs. Stewart's estate on an alleged transfer of her interest in the policies would be wrong.

We hope that we have impressed the Court with our representations and argument contained herein, but whether or not we have impressed the Court sufficiently to warrant a modification of its decision and an affirmance of the District Court, we cannot in good conscience ask this Court to do more at this time than to defer action on this Petition until the appellate court has reviewed the *Mendenhall* case. We believe the final determination in the *Mendenhall* case must necessarily establish California law, which will be determinative of the question as to whether the wife's interests in insurance policies covering her surviving husband's life were of such a nature that they could

be evaluated and subjected to federal estate taxes as part of her gross estate, and as to whether this Court's decision in the *Waechter* case is applicable.

Wherefore, upon the foregoing grounds, it is respectfully urged that this petition for rehearing be granted and that upon further consideration the judgment of the District Court be affirmed in its entirety.

Dated, July 6, 1959.

Respectfully submitted,

GEORGE H. KOSTER,

*Attorney for Appellee
and Petitioner.*

RICHARD W. GRAHAM,

Of Counsel.

CERTIFICATE OF COUNSEL

I, GEORGE H. KOSTER, attorney for the petitioner herein, do hereby certify that in my judgment the foregoing petition is well founded and is not interposed for the purpose of delay.

Dated, July 6, 1959.

GEORGE H. KOSTER.



No. 16017 /

United States
Court of Appeals
for the Ninth Circuit

GEORGE GILBERTSON,

Appellant,

vs.

CITY OF FAIRBANKS, a Corporation,

Appellee.

Transcript of Record

Appeal from the District Court
for the District of Alaska,
Fourth Division.

FILED

JUL - 8 1958

PAUL P. O'BRIEN, CLERK



No. 16017

United States
Court of Appeals
for the Ninth Circuit

GEORGE GILBERTSON,

Appellant,

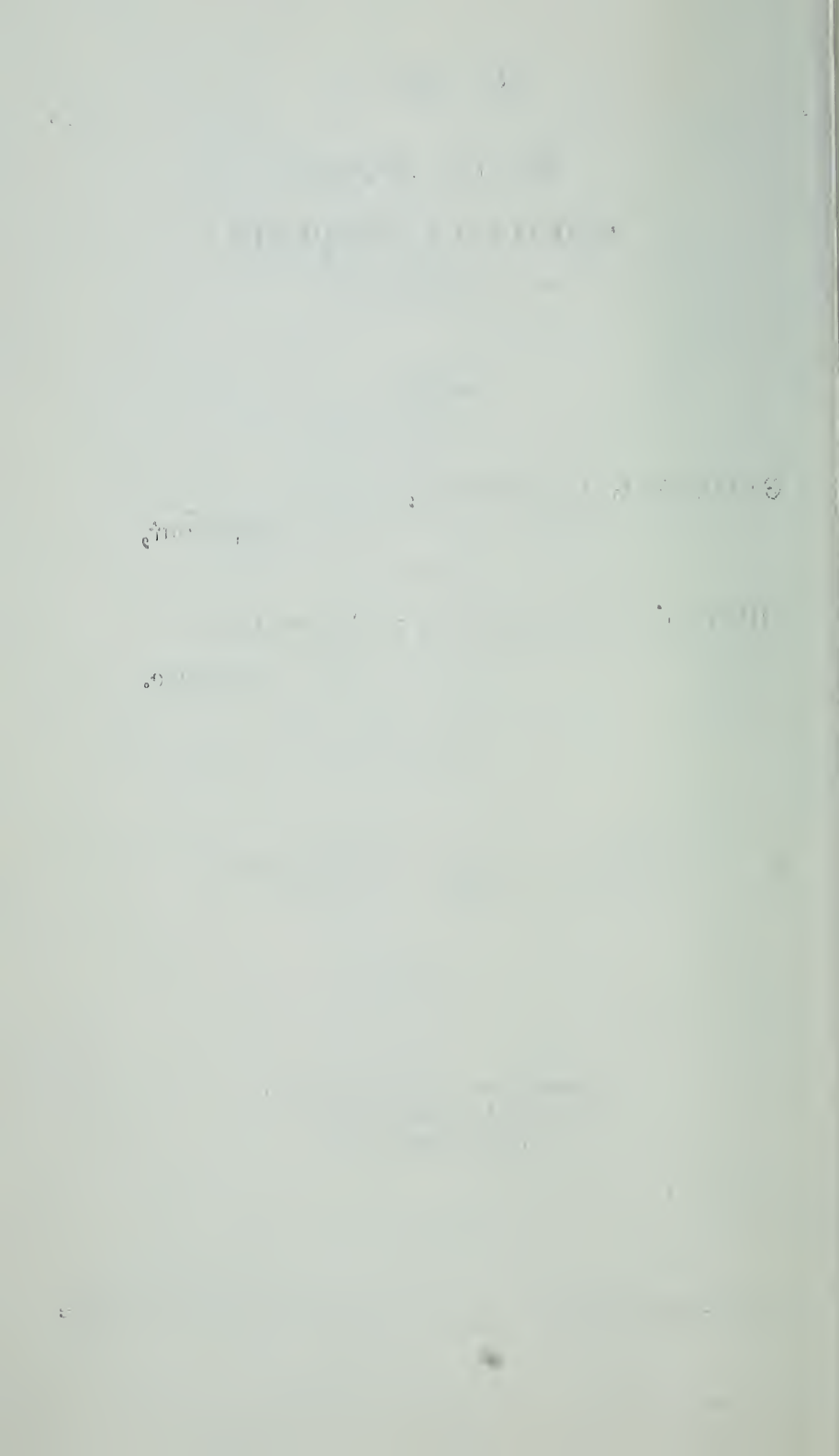
vs.

CITY OF FAIRBANKS, a Corporation,

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Fourth Division.



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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ATTORNEYS OF RECORD

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Attorney for Defendant and Appellant.

THE HISTORY OF THE

REIGN OF

EDWARD

THE FIRST

BY

JOHN

WYLLIE

OF

THE

UNIVERSITY OF

EDINBURGH

United States Court of Appeals
for the Ninth Circuit

No. 15567

GEORGE GILBERTSON,

vs.

CITY OF FAIRBANKS.

MANDATE

United States of America, ss:

The President of the United States of America

To the Honorable, the Judges of the District Court
for the Territory of Alaska, 4th Division,
Greeting:

Whereas, lately in the District Court for the Territory of Alaska, Fourth Division, before you or some of you, in a cause between City of Fairbanks, Plaintiff, and George Gilbertson, Defendant, No. 9210, an Order was duly filed and entered on the 6th day of February, 1957; which said Order is of record and fully set out in said cause in the office of the Clerk of the said District Court, to which record reference is hereby made and the same is hereby expressly made a part hereof.

And Whereas, the said George Gilbertson appealed to this court as by the inspection of the transcript of the record of the said District Court, which was brought into the United States Court of

Appeals for the Ninth Circuit by virtue of an appeal agreeably to the Act of Congress, in such cases made and provided, fully and at large appears.

And Whereas, on the 14th day of February, in the year of our Lord, one thousand nine hundred and fifty-eight, the said cause came on to be heard before the said United States Court of Appeals for the Ninth Circuit, on the said transcript of record, and was duly submitted:

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the appeal in this cause be, and hereby is dismissed. (February 14, 1958.)

You, Therefore, Are Hereby Commanded that such proceedings be had in said cause, in conformity with the judgment of this court, as according to right and justice, and the laws of the United States, ought to be had, the said appeal notwithstanding.

Witness the Honorable Earl Warren, Chief Justice of the United States, the nineteenth day of February, in the year of our Lord one thousand nine hundred and fifty-eight.

/s/ PAUL P. O'BRIEN,
Clerk, United States Court of Appeals for the Ninth
Circuit.

[Endorsed]: Filed February 21, 1958.

In the District Court for the District of Alaska,
Fourth Division

No. 9210

CITY OF FAIRBANKS, a Municipal Corporation,
Plaintiff,

vs.

GEORGE GILBERTSON,
Defendant.

MOTION FOR REHEARING AND TO REVISE
OPINION AND ORDER OF DISMISSAL
OR, IN THE ALTERNATIVE, FOR ENTRY
OF A FINAL JUDGMENT OF DISMISSAL
UNDER RULE 54(b) FRCP

1. Defendant herein, by Edgar Paul Boyko, his attorney, moves this Honorable Court for a rehearing and to revise the Opinion and Order of Dismissal of defendant's counterclaim entered herein on February 1, 1957, on the following grounds:

(a) On February 14, 1958, the U. S. Court of Appeals for the Ninth Circuit dismissed, without prejudice, defendant's appeal from said Order for the reason that said Order was not final and appealable under Rule 54(b) of the Federal Rules of Civil Procedure.

(b) Since the filing of the opinion of this Honorable Court herein on January 4, 1957, the Supreme Court of the United States, to wit, on Janu-

ary 28, 1957, decided the cases of *Rayonier, Incorporated, v. United States* and *Arnhold v. Same*, 352 U. S. 315, reversing prior judgments of the Court of Appeals for the Ninth Circuit and the United States District Court of the Western District of Washington. Defendant is advised by counsel and therefore believes that these recent decisions of the Supreme Court raise a new and substantial issue of law in the present cause and defendant therefore prays leave to submit briefs and arguments thereon at the early convenience of the Court and counsel, so that this Honorable Court may be able to fully consider this point which was not, and prior to the aforesaid decisions of the United States Supreme Court could not be presented to this Court. Also since the filing of the said Opinion and entry of said Order herein, the Legislature of the Territory of Alaska declared the law of the Territory in conformance with the said opinions of the U. S. Supreme Court, all of which defendant desires to present and argue fully before this Honorable Court.

(c) An apparent misunderstanding has arisen between plaintiff and defendant as to the intent of the Opinion and Order of this Honorable Court, referred to hereinabove, defendant believing in good faith that it was the purport of this Court to preclude any amendment of the counterclaim, so long as the same was based upon claimed liability for torts on the part of an Alaskan municipal corporation, while the plaintiff contends otherwise. If indeed it was the intention of this Honorable Court

to permit such amendment, defendant now desires to do so and requests that, in the interest of justice, the said Order be amended so as to permit this to be done.

2. In the alternative, if this Honorable Court does not see fit either to grant a rehearing or leave to amend the counterclaim as prayed above, defendant moves, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, for an Order directing entry of a final and appealable judgment of dismissal on the counterclaim for the following reasons:

(a) The said counterclaim is permissive and sets forth causes of action separate and distinct from, and entirely independent of, plaintiff's original claim and thus could have been brought as a separate action. Thus there is no reason not to separate the same for purposes of obtaining appellate adjudication of an important legal issue of first impression in the Territory of Alaska.

(b) There is no just reason for delay in entering such final judgment and once entered, the United States Court of Appeals for the Ninth Circuit has indicated that it is prepared to proceed on the original record and briefs of the first appeal herein (with appropriate supplementation) to avoid undue hardship to either party.

3. Defendant respectfully requests that in the event this Honorable Court desires further briefs and/or oral arguments on this Motion, that his

counsel, who is on extended leave of absence in the State of California, be given adequate notice to permit him to comply with the requirements of this Honorable Court and to attend any hearing which may be ordered herein.

BOYKO, TALBOT & TULIN,
Attorneys for Defendant;

By /s/ EDGAR PAUL BOYKO.

Points and Authorities

The foregoing Motion is based on Rule 54(b) of the Federal Rules of Civil Procedure, which provides in pertinent part that:

“When more than one claim for relief is presented in an action, whether as a claim (or) counterclaim * * * the court may direct the entry of a final judgment upon one or more but less than all the claims only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment. In the absence of such determination and direction, any order * * *, however designated, which adjudicates less than all of the claims * * * is subject to revision at any time before entry of judgment adjudicating all the claims.”

Rule 54(b) FRCP.

See also: 3 Bender's Federal Practice 434, 438, 441 (with Notes).

Respectfully submitted,

BOYKO, TALBOT & TULIN,
Attorneys for Defendant;

By /s/ EDGAR PAUL BOYKO.

[Endorsed]: Filed February 24, 1958.

In the District Court for the District of Alaska,
Fourth Division

No. 9210

CITY OF FAIRBANKS, a Municipal Corporation,
Plaintiff,

vs.

GEORGE GILBERTSON,
Defendant.

FINAL ORDER AND JUDGMENT
OF DISMISSAL

An Order having been entered herein on February 1, 1957, for dismissal of the causes of action set forth in the counterclaim of the defendant for the reason set forth in the Opinion filed hereintofore on January 4, 1957, and defendant's motion for rehearing and for an Order revising the said Opinion and Order having this day been denied; and

It appearing to this Court that there is no just reason for delay in entering final judgment of dismissal of defendant's said counterclaim and the action or actions therein set forth, it is, pursuant to

Rule 54(b) of the Federal Rules of Civil Procedure, directed, that final judgment upon said separate claims be entered; and it is, accordingly, hereby

Ordered, Adjudged and Decreed that the actions or causes of actions set forth in the first and second counts of defendant's counterclaim and the whole thereof be, and the same are, hereby finally dismissed without leave to amend.

Dated this 28th day of February, 1958, at Nome, Alaska.

/s/ WALTER H. HODGES,
District Judge.

Lodged February 29, 1958.

[Endorsed]: Filed and entered March 3, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that George Gilbertson, Defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit, from the Final Order and Judgment of Dismissal entered hereintofores on the 28th day of February, 1958, whereby Defendant's Motion for Rehearing and for an Order revising the Opinion and Order filed hereintofores on January 4, 1957, and February 1, 1957, respectively, was denied and the actions or causes of action set forth in the first and second count of Defendant's counterclaim and the whole thereof were finally dismissed without leave

to amend, conformably to Rule 54(b) of the Federal Rules of Civil Procedure.

Dated the 26th day of March, 1958.

BOYKO, TALBOT & TULIN,

By /s/ EDGAR PAUL BOYKO,
Of Attorneys for Appellant (Defendant) George
Gilbertson.

[Endorsed]: Filed March 28, 1958.

[Title of District Court and Cause.]

STATEMENT OF POINTS

The points upon which appellant intends to rely on this appeal are as follows:

1. Points 1 through 6, inclusive, of the statement of points filed hereintofore on April 29, 1957.

2. The Court erred in failing to take judicial notice of binding appellate precedents and legislative enactments which deprive appellee of the immunity from suit relied on in the order appealed from.

3. The Court abused its discretion in refusing to grant a rehearing and refusing to grant leave to appellant to amend his counterclaim.

/s/ EDGAR PAUL BOYKO,
Attorney for Appellant.

[Endorsed]: Filed May 5, 1958.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

1. Printed Record of previous appeal, separately bound, your number 15567.
2. Mandate dismissing Appeal.
3. Motion for Rehearing and to revise opinion and Order of Dismissal or, in the alternative, for entry of a final Judgment of Dismissal under Rule 54(b), F.R.C.P.
4. Final Order and Judgment of Dismissal.
5. Notice of Appeal.
6. Statement of Points.
7. Designation of Contents of Record on Appeal.

I, John B. Hall, Clerk of the above-entitled Court, do hereby certify that the foregoing list of proceedings in this cause comprise all proceedings listed on the Designation of Record of the defendant and appellant herein.

Witness my hand and the seal of the above-entitled Court this 12th day of May, 1958.

[Seal] /s/ JOHN B. HALL,
 Clerk of Court.

[Endorsed]: No. 16017. United States Court of Appeals for the Ninth Circuit. George Gilbertson, Appellant, vs. City of Fairbanks, a Corporation, Appellee. Transcript of Record. Appeal from the District Court for the District of Alaska, Fourth Division.

Filed May 16, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.



No. 16,018 ✓

IN THE

United States Court of Appeals
For the Ninth Circuit

ALBERT SMITH BIGELOW, WILLIAM
HUNTINGTON, GEORGE WILLOUGHBY
and ORION SHERWOOD,

Appellants,

VS.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the
District of Hawaii in Criminal No. 11,243.

APPELLEE'S ANSWERING BRIEF.

J. WALTER YEAGLEY,

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Internal Security Division,

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No. 16,018

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Appellants,

VS.

UNITED STATES OF AMERICA,

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APPELLEE'S ANSWERING BRIEF.

JURISDICTIONAL STATEMENT.

This is an appeal from a conviction and sentence in the United States District Court for the District of Hawaii for criminal contempt of court. This Court has jurisdiction under 28 U.S.C. §§ 1291 and 1294(1). Jurisdiction of the case below was based on 18 U.S.C. §§ 401(3), 402 and 3231, as well as upon Rule 42(b), Federal Rules of Criminal Procedure.

STATUTE AND REGULATION INVOLVED.

Section 161 of the Atomic Energy Act (42 U.S.C. § 2201, 68 Stat. 948) provides in relevant part:

In the performance of its functions the [Atomic Energy] Commission is authorized to—

* * * * *

(i) prescribe such regulations or orders as it may deem necessary (1) to protect Restricted Data received by any person in connection with any activity authorized pursuant to this Act, (2) to guard against the loss or diversion of any special nuclear material acquired by any person pursuant to section 53 or produced by any person in connection with any activity authorized pursuant to this Act, and to prevent any use or disposition thereof which the Commission may determine to be inimical to the common defense and security, and (3) to govern any activity authorized pursuant to this Act, including standards and restrictions governing the design, location, and operation of facilities used in the conduct of such activity, in order to protect health and to minimize danger to life or property;

* * * * *

(q) make, promulgate, issue, rescind, and amend such rules and regulations as may be necessary to carry out the purposes of this Act.

Section 232 of the Atomic Energy Act (42 U.S.C. 2280) provides:

Injunction Proceedings

Whenever in the judgment of the Commission any person has engaged or is about to engage in any acts or practices which constitute or will constitute a violation of any provision of this chapter, or any regulation or order issued thereunder, the Attorney General, on behalf of the United

States, may make application to the appropriate court for an order enjoining such acts or practices, or for an order enforcing compliance with such provision, and upon a showing by the Commission that such person has engaged or is about to engage in any such acts or practices, a permanent or temporary injunction, restraining order, or other order may be granted.

The contested Regulation of the Atomic Energy Commission (hereafter referred to as the Regulation) is set forth in full in Appendix "A", *infra*.

STATEMENT

On September 15, 1957, the Atomic Energy Commission and the Department of Defense issued notice of a proposed series of nuclear tests to begin in April 1958, at the Eniwetok Proving Grounds in the Pacific Ocean (2 R. 76).

On January 4, 1958, appellants (all except Sherwood) through a committee, of which they were a part, wrote the President of the United States urging him to cancel the tests (2 R. 38). On January 8, 1958, the committee again wrote the President that they intended to sail into the test area for the purpose of halting the tests (2 R. 40).

The Atomic Energy Commission, pursuant to authority granted under 42 U.S.C. 2201, issued a Regulation (23 F.R. 2401) effective April 12, 1958, designating specific portions of the Marshall Islands as a danger area during the "HARDTACK Test

Series," and prohibiting any American citizen or person subject to the jurisdiction of the United States from entering or attempting to enter the area during the course of the test series (Appendix A; 2 R. 7-9). After appellants made statements that they would sail to the test area and disregard the Atomic Energy Commission regulation, the United States Attorney for the District of Hawaii sought to restrain them from leaving Honolulu for the test area (2 R. 3-6). On April 24, 1958, Judge Jon Wiig of the United States District Court for the District of Hawaii issued a temporary restraining order preventing appellants from attempting to enter the designated area or from moving their vessel without permission of the Court (2 R. 10-13). On May 1, 1958, the Government's motion for a preliminary injunction and the appellants' motion to vacate the temporary restraining order were heard by Judge Wiig.

On the basis of an affidavit of Kenneth Fields, the General Manager of the Atomic Energy Commission, which stated that appellants' "action will impede the efficient and early completion of the HARDTACK series" (2 R. 76-9), and an affidavit by Admiral Arleigh Burke, Chief of Naval Operations, which stated that appellants' entry into the test area "will in fact interfere with the conduct of the tests", that "such interference is contrary to the security interests of the United States" and that "these United States nationals have not been authorized to participate in, witness or otherwise have access to the highly classified information which will be revealed during the

tests," (2 R. 82-4), Judge Wiig found that "[if] the defendants were allowed to enter or attempt to enter the aforesaid danger area, such act would preclude the effective enforcement of the Atomic Energy Act and would necessarily delay or interrupt the nuclear test series. . . ." He found as a matter of fact that appellants were American citizens and therefore subject to the AEC Regulation. Judge Wiig therefore found and concluded that the United States would suffer immediate and irreparable injury, and issued preliminary injunction restraining appellants from entering or attempting to enter the test area and from moving their vessel without the court's consent (2 R. 55-9).

Mr. Katsuro Miho, one of appellants' attorneys in the court below, informed the court that they "intended to go, regardless of the temporary injunction" (2 R. 117).

Shortly after the court adjourned and during the noon hour of the same day, appellants were apprehended by the Coast Guard while sailing their vessel out of Honolulu harbor in violation of Judge Wiig's order (1 R. 66-8).

On May 7, 1958, each appellant was found guilty of criminal contempt and sentenced to sixty days confinement, enforcement of which was suspended and appellants were placed on probation for one year (1 R. 20-3). This appeal is from that conviction.¹

¹Thereafter, appellant Bigelow announced that he would sail appellants' vessel to the test area beginning June 4, 1958. On that date, he was arrested for conspiracy to violate the temporary in-

SUMMARY OF ARGUMENT.

Appellants in their brief adopt points I through IV of the argument made in appellant's brief in *Reynolds v. United States*, No. 16,249 (pp. 9-68). We respectfully ask the Court that our answering arguments to those points in the *Reynolds* case be accepted here as the answers to the same points raised by these appellants. However, we do not consider the arguments in *Reynolds* under Point II to have any relevancy here inasmuch as that point in the *Reynolds* case involved a criminal prosecution for violation of the Regulation, whereas here this feature is absent.

Additional arguments to be made here are:

I. The Regulation of the A.E.C. did not unconstitutionally violate the appellants' right to freedom of

junction, and on June 6 was sentenced to sixty days imprisonment. Appellants Huntington, Willoughby and Sherwood did sail the vessel out of the harbor on June 4 but were intercepted by the Coast Guard and escorted back to port. These three appellants pleaded guilty and were sentenced on June 5, 1958 to serve sixty days for contempt. All four appellants served their sixty days sentences. (James Peck had joined Huntington, Willoughby and Sherwood on June 4 in their attempt to sail the craft to the test area. He was sentenced to sixty days for contempt, execution of the sentence being suspended, and he was placed on probation for one year.)

On May 23, 1958, this Court of Appeals denied appellants' motion for a stay and vacation of the preliminary injunction issued by Judge Wiig (per curiam order in *Bigelow, et al. v. U.S.*, No. 16,012). Appellants appealed the temporary injunction to this Court but the appeal was dismissed by stipulation in August 1958. On June 6, 1958, the appellants filed an application with the Supreme Court of the United States for an order staying all proceedings and suspending, vacating, or modifying the preliminary injunction. This application was denied by Mr. Justice Douglas on June 20, 1958. The Regulation having been revoked at the end of the test series, on November 14, 1958, the preliminary injunction was dissolved and the action dismissed as moot.

religion, contrary to the guarantee of the First Amendment.

II. The Regulation was validly issued without notice or opportunity for hearing because it was issued under the exceptions in respect thereto contained in the Administrative Procedure Act.

III. Finally, appellants cannot here collaterally attack the Regulation or the act under which it was issued. The court below had jurisdiction of the persons and the subject matter and therefore the appellants disobeyed the court's order at their own risk.

ARGUMENT.

I.

APPELLANTS WERE DENIED NO CONSTITUTIONALLY GUARANTEED RIGHTS TO FREEDOM OF RELIGION.

Appellants complain that the Regulation and the temporary restraining order here involved violated their rights to freedom of religion. They argue that they should have been allowed to enter the danger area and accept the danger involved from atomic explosions.² This, they contend, was their way of worshipping God.

While recognizing that the First Amendment to the Constitution expressly forbids legislation prohibiting

²This argument is premised upon the assumption that it was not their purpose to halt the tests—an assumption hardly warranted by their announced intention contained in the January 8, 1958 letter to President Eisenhower (2 R. 40).

the free exercise of religion, the Supreme Court in *Reynolds v. United States*, 98 U.S. 145, 164, said:

Congress was deprived of all legislative power over mere opinion, but was left free to reach actions which were in violation of social duties, or subversive of good order.

The court had before it the question of the guilt of one who knowingly violates a law which has been properly enacted, if he entertains a religious belief that the law is wrong. The court went on to say, at page 166:

... Laws are made for the government of actions, and while they cannot interfere with mere religious belief and opinions, they may with practices. Suppose one believed that human sacrifices were a necessary part of religious worship, would it be seriously contended that the civil government under which he lived could not interfere to prevent a sacrifice? Or if a wife religiously believed it was her duty to burn herself upon the funeral pile of her dead husband, would it be beyond the power of the civil government to prevent her carrying her belief into practice?

In answering these questions in the negative and in affirming that a man cannot excuse his practices because of his religious belief, the court said, at page 167:

... To permit this would be to make the professed doctrines of religious belief superior to the law of the land, and in effect to permit every citizen to become a law unto himself. Government could exist only in name under such circumstances.

To say that the acts sought to be done by these defendants would be done in the exercise of religious belief, and therefore would be under the protection of the constitutional guarantee of religious freedom, is "altogether a sophistical plea." Since the First Amendment to the Constitution provides:

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof,

it is pure sophistry indeed to say that the Regulation or the restraining order abridged religious freedom and rights of conscience of the defendants in violation of that amendment.

II.

**THE PROMULGATION OF THE COMMISSION REGULATION
BARRING ENTRY INTO A PRESCRIBED DANGER AREA BY
PERSONS SUBJECT TO THE JURISDICTION OF THE UNITED
STATES DID NOT CONTRAVENE THE PROVISIONS OF THE
ADMINISTRATIVE PROCEDURE ACT.**

In our argument in the *Reynolds* case under Point IV we discussed the question of the due process requirements of notice and hearing relating to the promulgation of the contested Regulation, but did not discuss the requirements of the Administrative Procedure Act. Appellants here raise this question by urging that the Regulation was invalid as not being promulgated in conformity with the provisions of the Administrative Procedure Act requiring notice and hearing (presumably referring to 5 U.S.C. 1000, *et seq.*).

A. Appellants' assertions plainly do not withstand analysis. Section 4 of the Administrative Procedure Act provides generally for advance notice of proposed rule making and public procedure on the rule making itself. This statutory enjoinder, however, is subject to two significant qualifications in that there is excepted therefrom rule making which involves, *inter alia*, "any military, naval or foreign affairs function of the United States" and "any situation in which the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in rules issued) that notice and public procedure thereon are * * * contrary to the public interest". (5 U.S.C. 1003).

Consonant with the foregoing, there is found in the disputed Commission Regulation, the following prefatory statement (22 F.R. 2401; see Appendix A):

In view of the importance of these tests to the *national defense*, the potential hazard to the health and safety of individuals who enter the danger area, and the early starting date of the tests, the Atomic Energy Commission has found that general notice of proposed rule making and public procedure thereon would be contrary to the public interest; and that good cause exists why these rules should be made effective without the customary period of notice.

Thus, there appears on the face of the questioned Regulation a statement of factors sufficient to bring the rule making procedure within the aforementioned exceptions of 5 U.S.C. 1003. This conclusion is rein-

forced by a more detailed consideration of these exceptions and their impact in this case.

The "military affairs" exception previously referred to is peculiarly appropriate for application here. Of this exception the authoritative Attorney General's Manual on the Administrative Procedure Act³ states (at p. 26):

"* * * *any military, naval, or foreign affairs function of the United States*". The exemption for military and naval functions is not limited to activities of the War and Navy Departments but covers all military and naval functions exercised by any agency. Thus, the exemption applies to the defense functions of the Coast Guard and to the function of the Federal Power Commission under Section 202(c) of the Federal Power Act (16 U.S.C. 824 a(c)). Sen. Rep. p. 39 (Sen. Doc. p. 225); Senate Hearings (1941) p. 502.⁴

That the nuclear weapons testing performed at the Eniwetok Proving Ground involves the exercise of a "military function" cannot seriously be questioned. As even the most casual examination of the Atomic Energy Act will reveal, the Commission is charged with significant responsibilities directly connected with the military defense of the United States (Sec., e.g., 42 U.S.C. §§ 2011-2013, 2035(a), 2037, 2121, 2153, 2162, 2163). Section 91(a) of the Atomic Energy Act of 1954, 42 U.S.C. 2121(a), pursuant to which nuclear

³Cf. *Kansas City Power and Light Co. v. McKay*, 225 F. 2d 924, 932 (C.A. D.C.), certiorari denied 350 U.S. 884.

⁴See also, Senate Report No. 752, 79th Cong., 1st Sess. p. 5.

weapons tests are conducted, expressly authorizes the Commission to "conduct experiments and do research and development work in the *military* application of atomic energy," and such tests are carried out, with Presidential approval, in cooperation with the Department of Defense. It would, therefore, seem apparent that this Regulation, implementing as it does the exercise of a Commission function "of major importance to the defense of the United States" (22 F.R. 2401), falls within the "military function" exception of 5 U.S.C. 1003.

In addition to the "military function" exception—which requires for its applicability no express statement of exception in the Regulation—Section 4 of the Administrative Procedure Act provides for other, stated, departure from the notice and public procedure requirements. Included among the latter is "any situation in which the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest" (5 U. S.C. 1004(a)). This additional basis for exception was spelled out, as required, in the preface to the Regulation in question. Appellants cannot successfully take issue with the sufficiency of this prefatory statement. The exceptions set forth in Section 4(a) are written in the alternative so that if it is "impracticable, unnecessary *or* contrary to the public interest" the agency may dispense with notice and public procedure. Accordingly, it was entirely ap-

propriate that the prefatory statement in the Regulation made reference solely to the "public interest" factor. Cf., Attorney General's Manual, *supra*, at p. 30.

Appellants emphasize the fact that their intention to sail into the test area was made known to responsible Government officials as early as January, 1958, and that, accordingly, the Commission had ample time for issuance of notice and the holding of a hearing prior to promulgation of the Regulation. Such an argument, however, disregards a number of contrary considerations. The determination as to when this Regulation would issue and whether public procedure should be allowed thereon was dependent on a complex of factors. To be gauged and taken into consideration in this regard were such things as the contemplated starting date of the test series, the actual impending danger of someone entering the test area, and (although the Regulation applied only to persons subject to the jurisdiction of the United States) possible foreign reaction to such a restriction. Patently, these considerations involved matters of Executive judgment. On the basis of information available to it, and after considering the views of the Government agencies concerned, the Commission determined that the "public interest" required issuance of the Regulation at the time and in the manner in which it was done. Such circumstances militate for according the Commission determination a heavy weight.

B. The additional argument which appellants seek to make in their brief, i.e., "that the regulation was

directed specifically to prevent these four appellants from making their non-violent protest'' adds nothing to the argument advanced by Reynolds in Point IV B of his brief. The factors which the Commission determined to be sufficient to dispense with notice are the same in both cases and hence are answered in the *Reynolds* brief.

Appellants' argument that the Regulation issued was adjudicatory of their rights is likewise without merit.

The Regulation here in issue was not aimed specifically at these appellants although their actions may have prompted the promulgation of the Regulation. All United States nationals alike were affected by the Regulation and nothing that appellants had done, as yet, was declared illegal. Rather what was proscribed by the Regulation was future conduct of appellants as well as any other national who may choose to enter the danger area (*e.g.*, *Reynolds*).

Therefore, if it were proper to dispense with notice as to appellant Reynolds, it was equally proper to dispense with notice as to appellants.

Moreover, in no sense of the word can this be considered a Bill of Attainder as appellants seem to imply.

Bills of Attainder are legislative acts that apply to either named individuals or to easily ascertainable members of a group in such a way as to inflict punishment on them without a judicial trial (*United States v. Lovett*, 328 U.S. 303, 315).

Since the Regulation was not directed against named individuals but rather against "nationals" as a group, the argument lacks merit.

In *American Communications Ass'n v. Douds*, 339 U.S. 382, the court upheld the validity of Section 9h of the National Labor Relations Act in the face of an attack made upon the ground that the Section was violative of the Constitution as a Bill of Attainder. In distinguishing the *Lovett* case, *supra*, the court said (*id.*, at 414):

Here the intention is to forestall future dangerous acts; there is no one who may not by voluntary alteration of the loyalty which impels him to action, become eligible to sign the affidavit. We cannot conclude that this section is a Bill of Attainder.

Here, by the same token, the intention of the Commission was to forestall *future* action. Since past action of the appellants was not declared unlawful by the Commission, by application of the rationale in *American Communications Ass'n v. Douds*, *supra*, the Regulation cannot be considered a Bill of Attainder.

It is not disputed here that the action of the appellants prompted the Atomic Energy Commission to issue the Regulation here in issue.

However, the fact that this knowledge may have prompted the Regulation in no way impairs the validity of the Regulation itself. Indeed, it has been said:

One step in the discovery of legislative meaning or intent is the ascertainment of the legisla-

tive purpose, i.e., the reasons which prompted the enactment of the law. * * * In seeking to ascertain the legislative purpose, it is proper to look at the circumstances existing at the time of the enactment of the statute, to the necessity for the law, the evils intended to be cured by it, to the intended remedy, and to the law as it existed prior to such enactment. *Otoe and Missouri Tribe of Indians v. United States*, 131 F. Supp. 265, 272, certiorari denied, 350 U.S. 848.

It has repeatedly been held also that resort to Legislative History is proper to ascertain the legislative intent. See *United States v. Great Northern Ry.*, 287 U.S. 144; *Duplex Printing Press v. Deering*, 254 U.S. 443.

Indeed, the legislative history of many of our statutes contains recitals setting forth reasons prompting the passage of such acts.

Certainly if judicial pronouncements condoning the practice of inquiring into the contemporaneous events to determine congressional intent have been made, the very fact that these events prompted the passage of the act could not in any way affect the validity of the act itself.

Judicial recognition has also been accorded to events which prompted legislation directed at particular groups of individuals. In *Galvan v. Press*, 347 U.S. 522, 529, the court took cognizance of the events which prompted the enactment of the statute:

On the basis of extensive investigation Congress made many findings, including that in § 2

(1) of the [Internal Security] Act that the "Communist movement . . . is a world-wide revolutionary movement whose purpose it is, by treachery, deceit, infiltration into other groups (governmental and otherwise), espionage, sabotage, terrorism, and any other means deemed necessary to establish a Communist totalitarian dictatorship," *and made present or former membership in the Communist Party, in and of itself, a ground for deportation.* (Emphasis supplied.)

And again in *American Communications Ass'n v. Douds, supra*, at 389, the court noted:

It is sufficient to say that Congress had a great mass of material before it which tended to show that Communists and others proscribed by statute had infiltrated union organizations not to support and further trade union objectives, including the advocacy of change by democratic methods, but to make them a device by which commerce and industry might be disrupted when the dictates of political policy required such action.

Certainly the very acts of those individuals who would be affected by the statute prompted enactment of the legislation, and in no way whatsoever impaired the validity of the statute.

Analogously, contemporary events, relating to the promulgation of a regulation can be resorted to in order to ascertain the purpose of a regulation, and these events can be the motivating factors for the Regulation itself.

III.

APPELLANTS HAVE NO STANDING HERE TO ATTACK THE
REGULATION OR THE ACT UNDER WHICH IT WAS ISSUED.

No one, no matter * * * how righteous his private motive, can be judge in his own case.

* * * * *

Only when a court is so obviously traveling outside its orbit as to be merely usurping judicial forms and facilities, may an order issued by a court be disobeyed and treated as though it were a letter to a newspaper.

Mr. Justice Frankfurter, concurring in *United States v. Mine Workers*, 330 U.S. 258, 308-9, 309-10.

This Court in *Colegrove v. United States*, 176 F.2d 614, 616, said:

It is settled law that unless an injunction is void its propriety must be tested by appeal and not by disobedience.

An injunction is not void if the court issuing it had jurisdiction over the subject matter and person. This is true without regard even for the constitutionality of the Act (or regulation) under which the order is issued. *United States v. Mine Workers*, *supra*, at 293, and cases there cited.

It is now held that, except in case of plain usurpation, a court has jurisdiction to determine its own jurisdiction. *Carter v. United States*, 135 F.2d 858, cited with approval in *United States v. Mine Workers*, *supra* at 292.

The *Mine Workers* case is undoubtedly the key case here and the Court's attention is respectfully invited to the entire part II, 330 U.S. 258 at 289-295, as well as to that part of Mr. Justice Frankfurter's concurring opinion at 307-312.

The situation is analogous here. The court below unquestionably had jurisdiction over the persons of the appellants, and it would seem specious to argue that it did not have jurisdiction over the subject matter. That the court would have to resolve substantial questions of law before granting a permanent injunction is granted. Acting upon a statute and a regulation valid on their faces, the court's action in issuing a temporary restraining order and a preliminary injunction to preserve the *status quo* pending a decision on the petition for a permanent injunction (or even upon its own jurisdiction) could hardly be called frivolous usurpation. The appellants, in making their private determination of the law, acted at their peril. Their disobedience was punishable as criminal contempt.

CONCLUSION.

The judgments should be affirmed.

Dated, Honolulu, Hawaii,

March 12, 1959.

Respectfully submitted,

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Acting Assistant Attorney General,

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LOUIS B. BLISSARD,

United States Attorney,

District of Hawaii,

Attorneys for Appellee.

(Appendix A Follows.)

Appendix "A"

lowing rules are published as a document subject to codification, to be effective upon filing with the FEDERAL REGISTER:

Sec. 112.1 Purpose.

112.2 Scope.

112.3 Definitions.

112.4 Prohibition.

Authority: §§ 112.1 to 112.4 issued under sec. 161, 68 Stat. 948, as amended; 42 U.S.C. 2201. Interpret or apply secs. 2, 3, 91, 68 Stat. 921, as amended, 922, 936; 42 U.S.C. 2012, 2013, 2121. For the purposes of sec. 223, 68 Stat. 958; 42 U.S.C. 2273, § 112.4 issued under sec. 161 i, 68 Stat. 949, 42 U.S.C. 2201 (i).

§ 112.1 *Purpose.* The regulations in this part are issued in order to permit the Atomic Energy Commission in the interest of the United States to exercise its authority pursuant to section 91 a. of the Atomic Energy Act of 1954, as efficiently and expeditiously as possible with a minimum hazard to the health and safety of the public.

§ 112.2 *Scope.* This part applies to all United States citizens and to all other persons subject to the jurisdiction of the United States, its Territories and possessions.

§ 112.3 *Definitions.* As used in this part:

(a) "Danger area" means that area established, effective April 5, 1958, encompassing the Bikini and Eniwetok Atolls, Marshall Islands and which is bounded by a line joining the following geographic coordinates:

18° 30' N., 156° 00' E.

18° 30' N., 170° 00' E.

11° 30' N., 170° 00' E.

11° 30' N., 166° 16' E.

10° 15' N., 166° 16' E.

10° 15' N., 156° 00' E.

(b) "HARDTACK test series" means that series of nuclear tests to be conducted by the Atomic Energy Commission and the Department of Defense at the Eniwetok Proving Ground located within the danger area as defined in paragraph (a) of this section and which are to begin in April 1958, and end at an announced time during the calendar year 1958.⁵

§ 112.4 *Prohibition.* No United States citizen or other person who is within the scope of this part shall enter, attempt to enter or conspire to enter the danger area during the continuation of the HARDTACK test series, except with the express approval of appropriate officials of the Atomic Energy Commission or the Department of Defense.

Dated at Germantown, Md., this 9th day of April 1958.

For the Atomic Energy Commission,

K. E. FIELDS,

General Manager.

[F. R. Doc. 58-2716; Filed, Apr. 11, 1958; 8:50 a.m.]

⁵This Regulation was withdrawn on September 8, 1958 (23 F.R. 6974).



Figure 1. Relationship between the number of species (S) and the number of individuals (N).

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (1)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (2)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (3)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (4)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (5)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (6)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (7)$$

where S is the number of species and N is the number of individuals.

The relationship between the number of species (S) and the number of individuals (N) is given by the equation:

$$S = f(N) \quad (8)$$

No. 16019 ✓

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

J. BRUCE ADAMSON, *et al.*,

Appellants,

vs.

UNITED STATES OF AMERICA, *et al.*,

Appellees.

BRIEF FOR APPELLEES.

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No. 16019
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

J. BRUCE ADAMSON, *et al.*,

Appellants,

vs.

UNITED STATES OF AMERICA, *et al.*,

Appellees.

BRIEF FOR APPELLEES.

Jurisdiction.

Appellants brought action in the Court below seeking damages under the Federal Tort Claims Act [Title 28, United States Code, Secs. 1346(b), 2671-2680—R. 2-7, 15-21].¹ The District Court ordered appellants' action "dismissed for lack of jurisdiction over the subject matter and for failure to state a claim upon which relief can be granted" [R. 50]. It is the position of appellees that the Court below did not have jurisdiction over the subject matter of appellants' action.

Since the order of the District Court dismissing appellants' action [R. 49-50] was a final decision, this Court has jurisdiction of an appeal from that decision pursuant

¹"R" indicates references to the typewritten Transcript of Record.

to Title 28, United States Code, Section 1291. However, the jurisdiction of this Court ends if it finds that the District Court was without jurisdiction of the subject matter [*United States v. Corrick*, 298 U. S. 435, 440 (1936)].

Statement of the Case.

Appellants filed in the District Court a Complaint [R. 2-7], and thereafter an Amended Complaint [R. 15-21], seeking damages under the Federal Tort Claims Act. The Complaints alleged, *inter alia*, that the United States owned certain lands [R. 2, 3, 16]; that one Curtis H. Springer advertised these lands through the United States mails [R. 4]; that said Springer sold to appellants a parcel of these lands for \$850.00 with representations through the mails that their money would be refunded if they were unsatisfied [R. 4, 18]; and that appellants thereafter demanded the return of their money, which was refused [R. 5, 18].

Appellees moved to dismiss appellants' action and each of their Complaints upon the grounds, among others, that the Court lacked jurisdiction over the subject matter and that the Complaints failed to state a claim upon which relief could be granted [R. 8-9, 22-23].

After a hearing upon appellee's motions [R. 30], the Court below determined that it lacked jurisdiction over the subject matter of appellants' action "since claims arising out of misrepresentation or deceit are by statute specifically exempted from the coverage of the Tort Claims Act, and that the Complaints on file herein fail to state a claim upon

which relief can be granted under the Tort Claims Act or otherwise" [R. 49-50]. The District Court ordered appellants' action and each of their Complaints dismissed [R. 50].

Issues Presented.

1. Did the District Court have jurisdiction over the subject matter of appellants' action under the Federal Tort Claims Act?

2. Did appellants' Complaints, or either of them, state a claim upon which relief can be granted, under the Federal Tort Claims Act?

Statutes Involved.

Title 28, United States Code, Section 1346(b) [Section 1346(b) of the Act of June 25, 1948, 62 Stat. 933, as amended by Section 2(a) of the Act of April 25, 1949] provides:

"§1346. United States as defendant

* * *

"(b) Subject to the provisions of chapter 171 of this title, the district courts, together with the District Court for the Territory of Alaska, the United States District Court for the District of the Canal Zone and the District Court of the Virgin Islands, shall have exclusive jurisdiction of civil actions on claims against the United States, for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the

United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred.”

Title 28, United States Code, Section 2680 [Section 2680 of the Act of June 25, 1948, 62 Stat. 984-985] provides in pertinent part:

“§2680. Exceptions

“The provisions of this chapter and Section 1346(b) of this title shall not apply to—

“(h) Any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights.”

ARGUMENT.

I.

The District Court Did Not Have Jurisdiction Over the Subject Matter of Appellants' Action Under the Federal Tort Claims Act.

Appellants allege that they were induced by the advertisements of one Curtis H. Springer to pay \$850.00 for a parcel of land, with representations that their money would be refunded if they were not satisfied [R. 4, 18]; and that they thereafter demanded the return of their money which was refused [R. 5, 18]. The original Complaint also avers that appellants secured judgments against Springer for \$850.00 plus interest, but implies that these judgments are not collectible [R. 5]. Appellants seek vaguely to attribute their loss to the United States.

It is manifest, however, that appellants' claim, if any, arose out of misrepresentation or deceit and such claims

were specifically excepted by statute from the coverage of the Federal Tort Claims Act.

Title 28, United States Code, Sec. 2680(h);

Miller Harness Co. v. United States, 241 F. 2d 781, 783 (2d Cir. 1957);

Clark v. United States, 218 F. 2d 446, 452 (9th Cir. 1954);

National Mfg. Co. v. United States, 210 F. 2d 263, 275-276 (8th Cir. 1954), *cert. den.* 347 U. S. 967;

Jones v. United States, 207 F. 2d 563 (2d Cir. 1953), *cert. den.* 347 U. S. 921;

Anglo-American and Overseas Corp. v. United States, 144 Fed. Supp. 635, 637-638 (S. D. N. Y. 1956), affirmed 242 F. 2d 236;

Social Security Admin. Baltimore F. C. U. v. United States, 138 Fed. Supp. 639, 650-651 (D. C. Md., 1956).

But compare:

Panella v. United States, 216 F. 2d 622 (2d Cir., 1954).

Nor may appellants evade this exception by contending that the United States negligently allowed the representations to be made. As this Court pointed out in *Clark v. United States*, *supra* (p. 452):

“* * * 28 U. S. C. A. §2680(h) exempts from the coverage of the Tort Claims Act any claim arising out of misrepresentation. *Misrepresentation as used in this section has been held to include negligent as well as intentional misrepresentation.* * * *”

Moreover, the Federal Tort Claims Act only covers injury or loss of property caused by the negligent or wrongful act or omission of *an employee of the Government while acting within the scope of his office or employment*. [28 U. S. C., Sec. 1346(b); *Pacific Freight Lines v. United States*, 239 F. 2d 191 (9th Cir., 1956); *Gardner v. United States*, 238 F. 2d 263 (Dist. Col. Cir., 1956); *Sickman v. United States*, 184 F. 2d 616 (7th Cir., 1950), *cert. den.* 340 U. S. 950.] And it has been held that “a complaint filed pursuant to the Federal Tort Claims Act must specify a definite act of commission or omission on the part of some particular employee or employees of the government.” [*Schetter v. Housing Authority of the City of Erie*, 132 Fed. Supp. 149, 152 (W. D. Pa., 1955).]

While in the case at bar the original Complaint intimates that one Curtis H. Springer was “manager” of government lands [R. 4], neither of the Complaints alleges that Springer was an employee of the Government *acting within the scope of his employment*. Indeed, both the original Complaint [Par. VIII—R. 5] and the Amended Complaint [Pars. IV, IX—R. 17, 18-21] would seem to establish that Springer was performing no governmental activity. The Complaints fail to specify a definite act of commission or omission on the part of any other employee or employees of the Government.

II.

Neither of Appellants' Complaints States a Claim Upon Which Relief Can Be Granted Under the Federal Tort Claims Act.

A. The Complaints Fail to State a Claim Against Defendants Other Than the United States.

In addition to the United States, the original Complaint named as defendant "His Excellency Dwight David Eisenhower, Chief Executive," while the Amended Complaint named as defendants "Laughlin E. Waters, U. S. Attorney, Joe Doe and Jenie Roe, Postmasters of the Town of Baker, California, and John Doe Whitmer."²

Suits under the Tort Claims Act should be brought against the United States exclusively [*Schetter v. Housing Authority of the City of Erie*, 132 Fed. Supp. 149, 153 (W. D. Pa., 1955); *Wickman v. Inland Waterways Corporation*, 78 Fed. Supp. 284 (D. C. Minn., 1948); cf., 28

²The Amended Complaint, in adding new parties without order of court violated Rule 21, Federal Rules of Civil Procedure [*Mitchell v. Carborundum Co.*, 7 F. R. D. 523 (W. D. N. Y. 1947)]. In joining fictitious parties, it also violated a local rule of the District Court [see, Order Re: Joinder of Fictitious Parties, following Rule 37, Rules of the United States District Court for the Southern District of California] which provides:

"ORDER RE: JOINDER OF FICTITIOUS PARTIES

"Effective on and after March 1, 1957, unless otherwise ordered by the Court in a particular case, the Clerk shall refuse to accept for filing, in any civil action or proceeding originally commenced in this Court, any complaint wherein any party is designated and sought to be joined under a name which is alleged to be, or for other reasons unquestionably is, wholly fictitious, unless the complaint be accompanied by a dismissal as to every party designated by a fictitious name. [See *Molnar v. National Broadcasting Co.*, 231 F. 2d 684, 687 (9th Cir. 1956).]"

The Court below nevertheless allowed the Amended Complaint to be filed [R. 30].

U. S. C., Sec. 2679]. Moreover, public officials are immune from personal liability for actions within the scope of their official powers [*Spalding v. Vilas*, 161 U. S. 468 (1896); *Gregoire v. Biddle*, 177 F. 2d 579 (2d Cir., 1949)].

B. The Complaints Fail to State a Claim Against the United States.

Appellants' Amended Complaint [R. 15-21] apparently proceeds upon the premise that the United States is liable because it failed to prevent them from being deceived. This premise is thinly veiled under the averment that appellees "negligently, wrongfully, and in omission of their duties suffered one Curtis A. Springer, and his *alter egos*, to establish, create and maintain an attractive nuisance, and a public nuisance on the said lands of the United States" [R. 17]. It may be inferred, although it is not explicitly alleged, that the neglect complained of consisted of permitting certain advertisements and other matter to pass through the United States mails [R. 18-21].

In an action under the Federal Tort Claims Act the Complaint must allege facts showing that the defendant breached a legally imposed duty owing to the plaintiff [*Wooldridge Manufacturing Company v. United States*, 235 F. 2d 513 (Dist. Col. Cir., 1953), *cert. den.* 351 U. S. 989]. The United States owed appellants as individuals no legal duty to protect them from deceit. While the Government in its sovereign capacity seeks to protect the public from fraud and other deceptions [see for example Sec. 1341 of Crim. Code, 62 Stat. 763, 18 U. S. C., Sec. 1341, which prohibits use of the mails to defraud, the Federal Food, Drug, and Cosmetic Act, 52 Stat. 1040, 21 U. S. C. A., Secs. 301 *et seq.*; the Federal Trade Com. Act, 38 Stat. 717, 15 U. S. C. A., Secs. 41 *et seq.*]; it incurs no

tort liability to the victim of any such fraud or deception [*Anglo-American and Overseas Corp. v. United States*, 144 Fed. Supp. 635, 637-638 (S. D. N. Y. 1956), affirmed 242 F. 2d 236; *Social Security Admin. Baltimore F. C. U. v. United States*, 138 Fed. Supp. 639, 650-651 (D. C. Md., 1956)].

The imposition of liability against the Government for its failure to protect the individual "against the need to exercise his own judgment" [see, *National Mfg. Co. v. United States*, 210 F. 2d 263, 280 (8th Cir., 1954), *cert. den.* 347 U. S. 967] has no analogous private liability [*cf.*, *Dalehite v. United States*, 346 U. S. 15, 43-44 (1953); *Feres v. United States*, 340 U. S. 135, 142 (1950)]. As the Supreme Court pointed out in *Dalehite*, where a suit under the Tort Claims Act had been instituted to recover damages for a death resulting from the disastrous explosion at Texas City, Texas (p. 43):

"As to the alleged failure in fighting the fire, we think this too without the Act. The Act did not create new causes of action where none existed before.

"... the liability assumed by the Government here is that created by 'all the circumstances,' not that which a few of the circumstances might create. We find no parallel liability before, and we think no new one has been created by, this Act. *Its effect is to waive immunity from recognized causes of action and was not to visit the Government with novel and unprecedented liabilities.*" *Feres v. United States*, 340 U. S. 135, 142.

It did not change the normal rule that an alleged failure or carelessness of public firemen does not create private actionable rights. * * *" [Emphasis supplied.]

Conclusion.

Wherefore, for the reasons set forth above, it is respectfully submitted that the judgment of the District Court should be affirmed.

Respectfully submitted,

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No. 16020

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

E. NADINE RODGERS,

Appellant,

vs.

UNITED STATES OF AMERICA.

Appellee.

APPELLANT'S OPENING BRIEF.

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No. 16020
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

E. NADINE RODGERS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

Jurisdiction.

The basic jurisdiction of the District Court is founded upon Title 18, U. S. C. A., Section 3231 (June 25, 1948), and initially arose in this case by reason of an indictment [Clk. Tr. 1] returned by the Grand Jury in the Southern District of California, Southern Division, in which appellant and her deceased husband were charged in one count with the illegal importation of narcotics in violation of Title 21, U. S. C. A., Section 174 (as amended July 18, 1956.) Hearing was had on a motion [Clk. Tr. 5] of appellant to suppress evidence under Rule 41(e)(4), Federal Rules of Criminal Procedure, Title 18, U. S. C. A., and, upon denial of the motion, trial was waived and by stipulation the cause submitted on the transcript and proceedings culminating in said hearing. Judgment [Clk. Tr. 58] was rendered finding appellant guilty as charged and sen-

tencing her to the custody of the Attorney General for a period of five years [Clk. Tr. 56].

The jurisdiction of this court was invoked by a notice of appeal [Clk. Tr. 60] under the provisions of Title 28, U. S. C. A., Section 1291 (June 25, 1948), and Rules 37 and 39 of the Federal Rules of Criminal Procedure, Title 18, U. S. C. A. (as amended December 27, 1948, effective January 1, 1949).

Statement of the Case.

Throughout this brief, all references to pages in the Clerk's Transcript will be preceded by the abbreviation "Clk. Tr.," while all references to pages in the Reporter's Transcript will be preceded by the abbreviation "Tr."

This is an appeal from a judgment of conviction by which appellant was sentenced to a five year term of imprisonment for the illegal importation of narcotics. Appellant seeks reversal of this judgment mainly on two grounds, viz., that the narcotics seized from her should have been suppressed inasmuch as they were obtained by a search made incident to an unlawful arrest and that the trial judge erred in refusing permission to appellant's counsel to inspect certain government reports from which Agent Clarence Spohr testified at the hearing on the motion to suppress the evidence. In addition to the aforesaid grounds, appellant objects to certain of the findings of fact and conclusions of law of the trial court.

The pertinent facts are as follows: At about 3:00 p.m., October 11, 1957, appellant's deceased husband, Evan W. Rodgers (hereinafter referred to as Rodgers), and one Gilbert Martinez (hereinafter referred to as Martinez) travelling together by automobile entered the United

States from Mexico at the port of entry at San Ysidro, California [Tr. 108]. After preliminary questioning by the customs inspectors at the border, they were taken to the secondary inspection area for further inspection and interrogation, since it was apparently felt by the inspectors that Rodgers might be guilty of failure to register as a former narcotics violator [Tr. 99]. A search of Rodgers' car revealed a suitcase containing woman's clothing and a document concerning a sale of real estate. Rodgers himself had a cashier's check for \$2,000.00 [Tr. 109-110]. At about 4:00 p.m., Agent Clarence Spohr arrived at the inspection station and began to interrogate Rodgers [Tr. 98]. According to Spohr, Rodgers told him that in 1952 he had been convicted of conspiracy to violate the narcotics laws in San Francisco [Tr. 100]; that he was a thoroughbred horse trainer [Tr. 100]; that he and his wife (appellant), in company with Mr. and Mrs. Martinez, had come south from San Francisco on a trip; that the two women stayed in Los Angeles with appellant's sister while Rodgers and Martinez and a Mexican lad named Manuel had gone to Tijuana to visit some friends of Rodgers at the race-track; that he had not found anyone he knew and was, in company with Martinez, returning to the United States [Tr. 100-102].

Following this conversation with Rodgers, Agent Spohr began to interrogate Martinez. At this time (it was about 5:00 p.m.) [Tr. 102], Martinez had already been detained for two hours. Martinez told Spohr that he was out on bail pending trial for a violation of the California narcotics laws (Section 11500 of the Health and Safety Code of the State of California) [Clk. Tr. 45; Tr. 124]; that he was a narcotics addict; and that he had had his most recent heroin injection within the last three days [Clk. Tr.

45; Tr. 128]. Spohr, an experienced customs agent, observed the hypodermic marks of a heroin addict on Martinez' arms [Clk. Tr. 45; Tr. 127]. Martinez then confided to Spohr that he had at one time acted as an informant for the Federal Bureau of Narcotics in San Francisco and, in this connection, mentioned several names which Spohr claimed to recognize as the names of narcotics agents operating in the San Francisco area [Clk. Tr. 45; Tr. 107-108, 125]. After over three hours of confinement and over two hours of continuous interrogation [Tr. 142-143], Martinez offered to make a deal with Spohr in that he agreed to "inform" the agents about certain illegal activities engaged in by appellant and her husband, if the government would grant immunity from prosecution for complicity to Martinez and his wife [Clk. Tr. 46; Tr. 142-143]. Agent Spohr told Martinez that he was "quite positive" the United States Attorney would "go along with anything along those lines" [Clk. Tr. 46; Tr. 143] and use Martinez and his wife as prosecution witnesses against Rodgers and appellant [Tr. 143]. At the time Martinez proposed to inform against his friends, he had been in custody for more than three hours [Tr. 143].

Upon receiving the foregoing assurance from Spohr, Martinez told him the following story: Martinez, his wife, appellant, Rodgers, and one Manuel Garcia, a cousin of Martinez, left San Francisco together on October 6, 1957. The object of the trip was to contact a connection of Garcia in Tijuana in order that Rodgers could purchase heroin. The entire group arrived in Tijuana on October 7, 1957, where Garcia bought some heroin from one "Red" or "Colorado" as he was known to the authorities. Rodgers at this time bought no narcotics because he had no ready cash. Rodgers had in his possession a check for

\$3,200.00 which he had received as part payment for the sale of some real estate. All five persons then returned to the United States and proceeded to Los Angeles, where Rodgers cashed his check receiving another check and some cash in return. Garcia represented to Rodgers that he could purchase heroin in Los Angeles thereby obviating the necessity of a return trip to Tijuana. Rodgers gave him \$600.00 to make a purchase, whereupon Garcia absconded with the funds. On October 9, 1957, Rodgers, appellant, Martinez, and his wife returned to Tijuana, where Rodgers purchased two contraceptives full of heroin. On October 11, 1957, appellant and Mrs. Martinez returned on foot to the United States at about 1:00 p.m. Rodgers and Martinez were to follow the women two hours later and meet them at the Greyhound Bus depot at San Diego [Finding of Fact No. 3, Clk. Tr. 45-48; Tr. 102-107].

Agent Spohr testified that he had never seen either Martinez or Rodgers prior to their interrogation [Tr. 129]; that he did not check any file or any report on Rodgers [Tr. 131] nor had he received a "tip" that Rodgers would be crossing the border on October 11, 1957 [Tr. 129]. Aside from one telephone call to the San Diego Police Department, which revealed a minor infraction of the law by Rodgers [Tr. 131], Spohr's sole basis for his subsequent action against appellant was the information he had gained by interrogating the two men and what he had observed of Rodgers' personal effects [Tr. 130]. He had not as yet seen or talked to appellant.

Sometime after 6:00 p.m. on October 11, 1957 [Clk. Tr. 47], acting upon the foregoing information, Agent Gates took Rodgers from San Ysidro to the San Diego Police Station to be booked for failure to register as a prior nar-

cotics convict. At the same time Agent Spohr and Martinez drove to the Greyhound Bus depot in San Diego, where Martinez had promised to point out his wife and appellant to the officers [Clk. Tr. 47; Tr. 110-111, 172, 177]. The officers had no warrant for appellant's arrest, nor did they attempt to get one [Tr. 153] despite the fact that the court house was within a block of their destination, the bus station [Tr. 149 *et seq.*]. The agents excused this oversight on the grounds that they felt time was of the essence [Tr. 153] and that, if they delayed, appellant would take the "bus north" [Tr. 115]. Arriving at the bus station in San Diego, Spohr and Martinez waited for Gates, who joined them about eight minutes later [Tr. 111-112] in the parking lot at the rear of the station. The three men proceeded into the station but, contrary to Martinez' information, appellant and Mrs. Martinez were not there [Tr. 112]. Martinez then saw the two women in the coffee shop of the Pickwick Hotel [Clk. Tr. 48; Tr. 112]. Preceding the two officers, Martinez by prearrangement entered the coffee shop and identified his wife for the agents by approaching her and kissing her [Tr. 112]. At this point the two agents approached the table and Agent Gates went through a prearranged sham arrest of Martinez [Tr. 184]. Agent Spohr identified himself to the women as a customs agent and asked them their names [Clk. Tr. 48; Tr. 113, 158]. Spohr informed them that they would have to accompany him [Clk. Tr. 48; Tr. 113, 159, 186]. The women immediately submitted to this request [Tr. 159] and began to get out of the booth to leave with the agents. As they were leaving the booth, the women in response to the agents' questions stated that they had just returned from Mexico and had there purchased a straw hat and a pair of shoes. Agent Gates noticed in their possession a shopping bag of a type known by

him to be commonly sold in Mexico [Clk. Tr. 48; Tr. 184]. After the two agents, Mr. and Mrs. Martinez, and appellant had left the coffee shop, Agent Spohr in response to an inquiry from appellant informed Mr. and Mrs. Martinez and appellant that they were under arrest and were being taken to the San Diego jail [Clk. Tr. 48; Tr. 113-114, 160, 185]. *At the time the two agents entered the coffee shop, they had already decided to arrest appellant* [Tr. 187].

Upon arrival at the jail, Agent Gates took Martinez aside to the booking office [Tr. 116], while Agent Spohr escorted the two women down a corridor toward a detention room [Tr. 116]. As Spohr and the two women proceeded down the corridor, Spohr noticed appellant trying to conceal a Kleenex tissue in her hand [Tr. 116]. He immediately demanded that she give it to him, which she did [Tr. 117]. Wrapped in the Kleenex was a contraceptive containing a substance which Spohr believed to be heroin [Tr. 117]. Spohr then demanded of appellant that she give him "the rest of it" [Tr. 117]; whereupon appellant took from her brassiere a second contraceptive containing heroin and gave it to Spohr [Tr. 117].

The case was presented to the Grand Jury in San Diego. Prior to the time a true bill was returned, appellant instituted a civil action in the District Court to restrain the United States Attorney, the agents, and others from securing the issuance of the indictment. This civil action was premised upon appellant's contention that the heroin was obtained from her by a search incident to an unlawful arrest. The trial court refused to make the restraining order and refused to stay the criminal proceedings pending determination of the question by this Honorable Court. A hearing on petitions for mandamus and prohibition was

held by Chief Judge Stephens, and Judges Lemmon and Barnes, in Los Angeles on January 7, 1958. The petitions were denied the following day.

A motion was made by appellant to suppress the seized evidence under the provisions of Rule 41(e)(4) [Clk. Tr. 5]. During the hearing on the motion, held on December 23 and 24, 1957 [Tr. 87 *et seq.*], Agent Clarence Spohr made repeated reference to certain notes he had made on the case presumably at the time of interrogating Rodgers and Martinez [Tr. 138, 139, 140, 141, 145, 164, 165]. During cross-examination, and for the purpose of aiding and developing the cross-examination, appellant's counsel requested that the notes be produced for his inspection [Tr. 165]. The trial judge interposed, examined the documents, and without hearing counsel for the defense on the question permitted only a restricted portion of the notes to be viewed by defense counsel [Tr. 165]. Defense counsel made two more requests to see the documents in question, both of which were likewise denied by the trial judge [Tr. 166]. With the exception above referred to defense counsel was denied all access to the requested notes. Upon conclusion of the hearing, appellant's motion to suppress was denied. Subsequent to the hearing, appellant's husband, Rodgers, met an accidental death and for that reason is no longer a party to this case.

On February 14, 1958, by stipulation, the parties waived formal trial and submitted the case as to the merits on the evidence introduced at the hearing on the motion to suppress [Clk. Tr. 56]. After consideration, the court decided the cause adversely to appellant. Following the court's decision, the findings of fact and conclusions of law were filed by the government. Objections to said findings and conclusions were filed [Clk. Tr. 38] which

resulted in amended findings and conclusions being submitted by the government and signed by the court [Clk. Tr. 44]. Despite appellant's objections, the following findings were finally adopted which, it is submitted by the appellant, are not supported by the evidence:

(a) The finding of fact that the court took judicial notice that it would occasion a delay of several hours to secure a warrant of arrest for appellant;

(b) The finding of fact that informer Gilbert Martinez told witness Spohr that appellant transported heroin across the border in her body cavity;

(c) The finding of fact that there was corroborating evidence for the story of informer Gilbert Martinez.

Likewise, appellant submits the following conclusions of law are not supported by the law, the findings, or the evidence:

(a) The conclusion of law that Agents Gates and Spohr had reasonable grounds to believe that appellant had brought heroin into the United States;

(b) The conclusion of law that there was independent corroboration for much of Martinez' statement to the officers;

(c) The conclusion of law that Agents Gates and Spohr believed the information supplied by Gilbert Martinez is not consistent in law with a reasonable belief founded upon the findings of fact and upon the evidence;

(d) The conclusion of law that the arrest of appellant was valid and legal;

(e) The conclusion of law enumerating the powers of arrest of treasury agents in so far as it purports

to conclude that the agents had reasonable grounds to arrest appellant without an arrest warrant;

(f) The conclusion of law that the agents had a right to search appellant following her arrest in so far as it purports to conclude that appellant's arrest was not unlawful;

(g) The conclusion of law that no search was made of appellant and that the seizure of heroin from appellant was valid and legal; that the appellant agreed to surrender the narcotics; and that no unreasonable means were used in so far as it purports to conclude that the seizure of heroin from appellant was in any way made possible by the voluntary disclosure of said heroin by appellant to the arresting officers.

Appellant's objection to the aforesaid findings and conclusions is preserved for appeal by reason of Rule 52 of the Federal Rules of Civil Procedure, Title 28, U. S. C. A., Rule 52(a), which provides in pertinent part:

"Requests for findings are not necessary for purposes of review."

Under said rule, all objections to findings of fact and conclusions of law are deemed reserved and are, accordingly, presented by the general appeal and the Statement of Points. Judgment was entered in this case under which appellant was sentenced to a five year term of imprisonment [Clk. Tr. 58]. This appeal followed [Clk. Tr. 60].

Summary of Argument.

I.

INTRODUCTION.

II.

APPELLANT'S RIGHTS UNDER THE FOURTH AMENDMENT TO THE FEDERAL CONSTITUTION WERE VIOLATED BY THE ACT OF THE CUSTOMS OFFICERS IN ARRESTING HER WITHOUT A WARRANT.

III.

CERTAIN OF THE FINDINGS OF FACT ARE NOT SUPPORTED BY THE EVIDENCE.

- (a) *The findings of fact that the court took judicial notice that it would occasion a delay of several hours to secure a warrant of arrest for appellant is not supported by the evidence.*
- (b) *The finding of fact that informer Gilbert Martinez told witness Spohr that appellant transported heroin across the border in her body cavity is not supported by the evidence.*
- (c) *The finding of fact that there was corroborating evidence for the story of informer Martinez is not supported by the evidence.*

IV.

CERTAIN OF THE CONCLUSIONS OF LAW ARE NOT WELL TAKEN IN LAW, NOR ARE THEY SUPPORTED BY THE FINDINGS OF FACT OR BY THE EVIDENCE.

- (a) *The conclusion of law that Agents Gates and Spohr had reasonable grounds to believe that appellant had brought heroin into the United States is not supported in law, by the findings of fact, or by the evidence.*
- (b) *The conclusion of law that there was independent corroboration for much of Martinez' statement to the officers is not supported in law, by the findings of fact, or by the evidence.*

- (c) *The conclusion of law that Agents Gates and Spohr believed the information supplied by Gilbert Martinez is not consistent in law with a reasonable belief founded upon the findings of fact and upon the evidence.*
- (d) *The conclusion of law that the arrest of appellant was valid and legal is not supported in law, by the findings of fact, or by the evidence.*
- (e) *The conclusion of law enumerating the powers of arrest of treasury agents is not supported in law, by the findings of fact, or by the evidence in so far as it purports to conclude that the agents had reasonable grounds to arrest appellant without an arrest warrant.*
- (f) *The conclusion of law that the agents had a right to search appellant following her arrest is not supported in law, by the findings of fact, or by the evidence, and particularly is not so supported in so far as it purports to conclude that appellant's arrest was not unlawful.*
- (g) *The conclusion of law that no search was made of appellant, that the seizure of heroin from appellant was valid and legal, that the appellant agreed to surrender the narcotics, and that no unreasonable means were used is not supported in law, by the findings of fact, or by the evidence, and particularly is not so supported in so far as it purports to conclude that the seizure of heroin from appellant was in any way made possible by a voluntary disclosure of said heroin by appellant to the arresting officers.*

V.

IT WAS ERROR FOR THE TRIAL COURT TO REFUSE TO PERMIT APPELLANT'S COUNSEL TO EXAMINE THE REPORT FROM WHICH WITNESS SPOHR REFRESHED HIS RECOLLECTION WHILE TESIFYING AT THE TRIAL.

ARGUMENT.

I.

Introduction.

This is an appeal by E. Nadine Rodgers, appellant herein, from a conviction of unlawful importation of narcotics. At the outset it should be made clear that appellant admits that contraceptives seized from her at the San Diego police station did contain heroin and that she did bring said heroin into this country from Mexico on October 11, 1957. However, appellant contends that the arresting officers, although acting in personal good faith [Tr. 120], did not have probable cause to arrest appellant without a warrant and that appellant's motion, brought under Rule 41(e)(4), to suppress the evidence should have been granted by the court below. Appellant further contends that in addition to certain erroneous findings of fact and conclusions of law hereinafter treated the Honorable Trial Judge erred in refusing appellant's counsel the opportunity to inspect the report used by Agent Spohr in testifying at the hearing on the motion to suppress.

II.

Appellant's Rights Under the Fourth Amendment to the Federal Constitution Were Violated by the Act of the Customs Officers in Arresting Her Without a Warrant or Probable Cause.

Appellant first assigns as error the failure of the trial court to grant appellant's motion to suppress the evidence, under Rule 41(e)(4) of Title 18, U. S. C. A., based upon the fact that the arresting officers violated appellant's Fourth Amendment rights by arresting her without a warrant and without probable cause.

Restrictions on the arresting power of federal peace officers find their genesis in the constitutional interdiction of the Fourth Amendment to the Federal Constitution which provides:

“The right to the people to be secure in their persons, houses, papers and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause supported by Oath or affirmation, and particularly describing the place to be searched, and the person or things to be seized.”

Although not specifically permitted by the strict wording of the Amendment, it is, of course, axiomatic that all arrests need not be made upon warrant. Peace officers have certain residual powers in the absence of an arrest warrant which have carried down since the earliest days of the common law. It has long been established that in the absence of a specific federal arrest statute federal officers are governed by the arrest practice which prevails in the state in which the arrest is made.

Cline v. United States (9th Cir., 1925), 9 F. 2d 621;

United States v. Horton, 94 Fed. Cas. 15393.

Looking to the rule of arrest to be followed in the instant case, we find that the arresting agents, Spohr and Gates, were agents of the United States Customs Service and that they arrested appellant for an alleged violation of the federal narcotics laws. While there is a question whether customs agents had such power prior to 1956, since that time the question admits no argument as in that year

Congress passed Title 26, U. S. C. A., Section 7607, which provides in pertinent part:

"The Commissioner, Deputy Commissioner, Assistant to the Commissioner, and agents of the Bureau of Narcotics of the Department of the Treasury, and officers of the customs (as defined in Section 401(1) of the Tariff Act of 1930, as amended; 19 U. S. C., sec. 1401(1)), may—

* * * * *

"(2) make arrests without warrant for violations of any law of the United States relating to narcotic drugs (as defined in section 4731) or marihuana (as defined in section 4761) where the violation is committed in the presence of the person making the arrest or where such person has reasonable grounds to believe that the person to be arrested has committed or is committing such violation."

The foregoing statute merely codifies for a specific class of violations the powers of arrest classically possessed by peace officers at the common law. Historically where a violation was committed without his presence a peace officer was justified in making arrests without a warrant only where he possessed sufficient personal knowledge such as would justify a reasonably prudent man to believe that a felony had been committed and that the arrestee had probably been the offender. Mere suspicion on the part of the officer, no matter how well intentioned, is not a sufficient predicate for a valid arrest. As stated by the Eighth Circuit:

"The proper test, supported by the great weight of authority, * * * is were the circumstances presented to the officers through the testimony of their

senses sufficient to justify them in a good-faith belief that plaintiff in error was in their presence transporting liquor in violation of law or that he had in their presence liquor in his possession in violation of law? In other words, was there probable cause for them to so believe, or were the facts sufficient to give rise merely to a suspicion thereof? If the former the arrest was legal and the evidence secured by it admissible. If the latter, the arrest was illegal, and the evidence obtained not admissible.”

Garske v. United States (8th Cir., 1924), 1 F. 2d 620, 625, quoted with approval by this court in *Brown v. United States* (9th Cir., 1925), 4 F. 2d 246.

The question of what constitutes “probable cause” is a troublesome one, but this court in

Hernandez v. United States (9th Cir., 1927), 17 F. 2d 373,

adopted the rule expressed in 2 R. C. L. 451, in defining probable cause, as follows:

“Probable cause for an arrest has been defined to be a reasonable ground of suspicion, supported by circumstances sufficiently strong in themselves to warrant a cautious man in believing the accused to be guilty.”

See also:

United States v. Walker (7th Cir., 1957), 246 F. 2d 519.

The question of whether the agents in the instant case had probable cause for arresting appellant was raised by appellant on her motion to suppress the evidence brought under Title 18, U. S. C. A., Rule 41(e)(4), which motion made it incumbent upon the government to establish

that the arresting agents were possessed of such knowledge that as reasonably prudent men they believed beyond mere suspicion that appellant had violated the federal narcotics laws. The basic purpose to be accomplished by the government's proof at such a hearing is not to establish the ultimate fact of whether or not a given defendant is actually guilty of a crime, but, rather, to show the state of mind of the arresting officer at the instant of arrest, more particularly, to show that in his mind he, as a reasonable person, believed that there was a reasonable probability that a crime had been committed and that the defendant had committed it. If the government's proof establishes this state of mind to the reasonable satisfaction of the magistrate, it can be said that the arresting officer had probable cause for his actions and the arrest and incidental searches thereto were valid.

At the hearing below, only two witnesses testified, viz., Agents Gates and Spohr, and both of them for the government. Since the appellant called no witnesses and, with the exception of an affidavit, adduced no evidence, their testimony as to the facts upon which they formed their belief stands uncontradicted. However, appellant contends that, even accepting the government's evidence, it is clear beyond peradventure that the agents did not possess that requisite degree of certainty as would constitute probable cause for arrest without a warrant.

Reviewing then the evidence upon which the arresting agents relied in determining in their minds that they had probable cause to arrest appellant without a warrant, it is apparent that the only evidentiary facts which may be considered were those which were gleaned by the agents in the period which commenced on their arrival at the inspection station at San Ysidro and ended with their arrest

of appellant in the coffee shop of the Pickwick Hotel some five hours later. Prior to the time of arrival at San Ysidro, the agents had never seen or heard of either Martinez or Rodgers [Tr. 129]. They had received no advance tip that Rodgers or Martinez was engaged in smuggling activity [Tr. 129]. The agents did not check any files or reports on Rodgers [Tr. 131]; nor, with the exception of a telephone call to the San Diego police which revealed a minor infraction of the law by Rodgers, did they make any outside inquiry as to his reputation or character [Tr. 131]. It nowhere appears that the agents even knew of the existence of appellant or her presence in the area prior to the information they received during their interrogations. As of the time that Agent Spohr began to interrogate Gilbert Martinez, his information consisted of the following facts: that Rodgers had a prior narcotics conviction; that he was coming into the United States from Tijuana; that he lived in San Francisco and had gone to Tijuana for the purpose of seeing some friends around the racetrack; that he had met no one he knew at the racetrack; that his wife had accompanied him from San Francisco but had remained in Los Angeles with her sister; that he carried on his person a check for \$2,000 and a small amount of cash; and that luggage in the trunk of Rodger's car contained woman's clothing and some papers relating to the sale of real property.

The agents at this time did not know that appellant was anywhere within the Southern Division of the Southern District of California. The major portion of the information upon which the agents acted in arresting appellant was obtained from Agent Spohr's interrogation of Martinez. During the first two hours of his interrogation, Martinez gave Spohr only general information, viz., that he was

on bail pending trial for a violation of Section 11500 of the California Health and Safety Code [Tr. 124]; that he was a narcotics addict and had had his most recent heroin injection three days before [Tr. 128]; and that he had at one time acted as an informant for the Federal Bureau of Narcotics in San Francisco and had worked with certain agents whose names were familiar to Spohr. In addition, during this time Spohr noticed the marks of a heroin addict on Martinez's arms. It was not until after two hours had passed that Spohr received any information from Martinez which bore on appellant. At this time, Martinez offered to give information about alleged illegal activities involving appellant in return for a pledge of immunity from prosecution for himself and his wife [Tr. 142-143]. Having received a positive assurance of immunity from Spohr [Tr. 143], Martinez then told Spohr the story which has been heretofore set out in the Statement of the Case in this brief. Most pertinent to appellant was the information that she had accompanied Martinez and Rodgers to Tijuana; that Rodgers had suggested that she conceal heroin in her body cavity and, in company with Mrs. Martinez, cross the border into the United States at 1:00 p.m., on October 11, 1957; that the women had, in fact, crossed the border at that time and were then waiting for Martinez and Rodgers in the Greyhound Bus depot at San Diego.

Taking the information received from Martinez and Rodgers in conjunction with the products of the border inspectors' search of Rodgers' automobile and person, the agents decided that they possessed sufficient information to have probable cause to believe that a crime had been committed and that appellant was the perpetrator thereof. Having made this decision, the agents proceeded im-

mediately to the Greyhound Bus depot in San Diego for the purpose of apprehending appellant. No attempt was made to secure a warrant either by calling ahead to some magistrate or by seeking a magistrate once San Diego was reached. The agents testified that, since they felt that time was of the essence and appellant might take the next bus north, they need not make an attempt to secure a warrant for her arrest. Appellant was located in the coffee shop of the Pickwick Hotel in San Diego and at the time the agents entered the coffee shop they had already made up their minds, on the basis of their then information, to arrest appellant.

Agent Spohr approached the table at which appellant was sitting with Mrs. Martinez and identified himself as a customs officer and asked them their names. He then immediately informed them that they would have to accompany him [Clk. Tr. 48; Tr. 113, 159, 186]. Although the formal ritual of arrest was not performed until some moments later after the women were outside the coffee shop, it is the position of the appellant that, inasmuch as she submitted immediately to Spohr's request made under color of authority, the arrest actually took place at the moment that he requested the women to come with him. Thus in

People v. Randolph (1957), 147 Cal. App. 2d 836,
841, 306 P. 2d 98,

it was held that an arrest was accomplished by the submission to custody of a motorist who stopped and alighted from his vehicle when he saw a police car following him, and was accused at that time by the policeman of a violation of a section of the Vehicle Code.

Of particular applicability are the words of Judge McAllister in his dissenting opinion in

Gilliam v. United States (6th Cir., 1951), 189 F. 2d 321, 327:

“If officers do not have probable cause to arrest or search, their restraint of another’s freedom of locomotion by words, acts, or the like, which would induce a reasonable apprehension that force would be used unless he submitted, constitutes an arrest. To constitute an arrest, it is not necessary to touch the person of one who is arrested, or to state to him that he is arrested.”

See also:

Willson v. Superior Court (1956), 46 Cal. 2d 291, 294 P. 2d 36;

People v. Martin (1955), 45 Cal. 2d 755, 290 P. 2d 855.

Since the arrest was made as aforesaid when appellant peacefully submitted at the request of Agent Spohr, events which occurred subsequent to the arrest cannot be held to be corroborative of the information possessed by the arresting officers. Thus in arriving at the question of whether the officers had probable cause to arrest appellant, no credence can be given to the statement of the women that they had just returned from Mexico; that they had there purchased a straw hat and pair of shoes; and that they had in their possession a shopping bag of a type commonly sold in Mexico. These last bits of information being ascertained by the officers subsequent to the arrest could have no bearing upon their state of mind as to probable cause for the arrest; nor can any extra aura of truthfulness be accorded to Martinez’s information merely because it ultimately turned out to be correct

in that appellant did possess heroin as he said, it being well established that the legality of an arrest cannot be aided by what a search incident thereto turns up. Thus, as stated in

United States v. Di Re (1948), 332 U. S. 581,
92 L. Ed. 210, 220:

“We have had frequent occasion to point out that a search is not to be made legal by what it turns up. In law it is good or bad when it starts and does not change character from its success.”

See also:

Byars v. United States (1927), 273 U. S. 28, 29,
71 L. Ed. 520, 522;

Gilliam v. United States (6th Cir., 1951), 189 F.
2d 321, dissenting opinion, 326, 327, *supra*.

A recital of the information available to the officers which prompted their action in arresting appellant clearly points up the fact that the motivating information consists entirely of the information furnished to them by the informer Martinez. Absent his story, there was no probable cause to arrest appellant. In fact, it was only through the information proffered by Martinez that the agents even knew of appellant's presence in the vicinity.

The crucial question on this segment of the appeal is thus whether the information given by Martinez in and of itself constitutes probable cause for the arrest of appellant without a warrant. It is the appellant's firm position that it does not. It clearly appears from the facts of this case that prior to the time Agent Spohr arrived at the inspection station at San Ysidro he knew nothing of Martinez. He had never seen him. He had never heard of him [Tr. 129]. He had had no prior dealings with him either

as an informant or otherwise. In so far as the arresting agents were concerned, despite his story of having been an informer for narcotics officers in San Ysidro, the reliability of Martinez was an unknown factor.

The proposition that the uncorroborated tip of an informant of unknown reliability does not constitute probable cause for arrest without a warrant is too well established to admit a doubt. The reason for the rule is clear. Unless the officers have had prior dealings with an informant which would establish his reliability, they have no way of gauging the motivations which prompt the informer to supply his information. Were the Safeguard of established reliability to be bypassed, immeasurable harm and embarrassment could result to innocent persons. An arresting officer in the exercise of his authority could become the tool of an informant whose possible motivation runs the gamut from sheer mischief to calculated self aggrandizement. Likewise, unless the snaffle of reliability be retained, over-zealous officers of the law could, by repeated arrests based upon mere supposition, conjecture, or surmise, set at naught the protections afforded by the Fourth Amendment.

The courts have repeatedly recognized the necessity for requiring a showing of previous reliability of the informer if they are to uphold an arrest without a warrant based solely on the informer's tip. As was stated in

United States v. Turner (D. C. Md., 1954), 126
Fed. Supp. 349,

in quoting a treatise on the law of search and seizure by Ernest W. Machen, Jr.:

“Tips from reliable informers, if backed up by some personal knowledge on the part of the officer, as in a case where he has checked his information

against actual conditions, may be very valuable. Some cases seem to go so far as to say a search may be made on information which the officers believe to be reliable as distinguished from that which they know to be true from their own knowledge, or from information which they have checked. But the general rule seems to be that tips must be supplemented by further facts before they can be relied on. It is uncertain whether names of informers must be disclosed. It has been said that "public policy forbids disclosure of an informer's identity unless essential to the defense." Yet searches are generally not approved if there is no other evidence than a tip by an undisclosed informer.' "

In

United States v. Castle (D. C., 1955), 138 Fed. Supp. 436, at 439,

the court stated:

"An arrest or warrant for an arrest may not be based upon the suspicion or opinion of some person, unsupported by personal knowledge of the facts, and a warrant to search a private home may not rest upon a mere statement of suspicion without the disclosure of supporting facts and circumstances to justify the suspicion. (Citing cases.)

"The Court has reached the conclusion that the arrest was illegal; that the uninvestigated tip of this informer was not sufficient to establish the probable cause needed for a legal arrest.

"While we do not question the good faith of the officers, their subjective good faith is not enough unless it is bottomed upon facts within their personal knowledge, some of which at least, would be competent as evidence in the trial of the offense before a jury. (Citing cases.)

“Here the officers assumed the reliability of the informer and accepted the tip as gospel. They were able to relate it to the defendant as being the same individual about whom they had heard rumors in the past. But there was no emergency. The officers had heard of defendant’s activities in the past. They had no reason to believe that he was about to flee or suddenly cease peddling narcotics. There was no compelling reason why they could not have had the house put under general surveillance until they were able to obtain a search warrant the next morning. Yet no such steps were taken, nor did the officers obtain, nor even seek to obtain, an affidavit of the informer. Under these circumstances we cannot sanction this arrest. Declaration of, and reliance upon suspicion or belief, without more, will not do. See *United States v. Reynolds*, D. C. 1953, 111 F. Supp. 589.

“While the evidence might be construed to infer that the officers were justified in going to the apartment of defendant to question him about the accusation, the more reasonable inference is that they went to the apartment for making an arrest. (Citing cases.)”

In

United States v. Blich (D. C. Wyo., 1930), 45 F. 2d 627,

the court expressly recognized the danger of harassment, embarrassment, humiliation and vexation of innocent parties which could arise by permitting arrests to be made solely upon the information supplied by informants of unknown reliability when it said at 629:

“It is conceivable that a prohibition agent in the earnestness and eagerness of performing his duty might adopt very shadowy leads. But what is of greater consequence is that an ill-intentioned person

might give an officer information which would in many instances lead to humiliation and vexation of the innocent automobile driver upon the public highway, * * *."

In

Contee v. United States (D. A. D. C., 1954), 215
F. 2d 324, 326,

the arresting officers had received information from a man living in Contee's neighborhood that Contee "'was the party that had been involved in some robberies.'" Based upon this information, the officers proceeded to Contee's house and knocked on the door. After a long interval Contee opened the door and was arrested by the officers. A search resulted and certain incriminating items were discovered. During the trial, Contee's motion to suppress these items as evidence was denied and Contee appealed from a judgment of conviction. The Court of Appeals for the District of Columbia in reversing and remanding for a new trial stated at page 327:

"The question is—did the officer making the arrest have probable cause to believe that the person arrested had committed an offense? See *Mills v. United States*, 90 U. S. App. D. C. 365, 196 F. 2d 600, certiorari denied, 1952, 344 U. S. 826, 73 S. Ct. 27, 97 L. Ed. 643. As we have seen, the officer here testified that an individual who 'lived in the neighborhood, apparently, and knew Contee' was his sole source of information. *An uncorroborated tip by an informer whose identity and reliability are both unknown does not constitute probable cause to make an arrest.*" (Emphasis added.)

See also: cases cited in Note 1, page 327 of 215 F. 2d.

In

Worthington v. United States (6th Cir., 1948),
166 F. 2d 557,

appellant's living quarters were searched by the arresting officers and a considerable store of narcotics was discovered in the search. Appellant's motions to suppress the evidence were denied and the appellant convicted. On appeal the Court of Appeals for the Sixth Circuit extensively considered the point of whether the officers had probable cause to believe that appellant was committing a felony such as would justify a search of her living quarters and an arrest of her person without a warrant. Relative to the issue of probable cause it appeared that an agent of the Federal Bureau of Narcotics received a telephone call from a man who refused to give his name. However, the caller asked questions of the agent relating to the agent's knowledge of other persons involved in the narcotics traffic. The information divulged by the unknown caller relative to these other persons was to the agent's knowledge correct. The caller then stated to the agent that he had information that appellant was likewise engaged in the narcotic traffic and told the agent that appellant was concealing narcotics in a storeroom and a safe in her home. Following the anonymous telephone call the agent proceeded to "corroborate" the information by checking the files of the Federal Bureau of Narcotics. These files reflected an investigation of appellant's paramour that had been carried on by an Agent Rudd some years previously. Some of the information in the files related to appellant. There was also testimony that a girl who had been convicted of a narcotics violation had at one time resided in a sporting house operated by appellant in Saginaw, Michi-

gan. The court in reversing and remanding remarked at page 564:

“‘A search warrant may issue only upon evidence which would be competent in the trial of the offense before a jury (citing cases); and would lead a man of prudence and caution to believe that the offense had been committed. (Citing cases.)’

“What is set forth as the requirement for evidence to justify the issuance of a search warrant, applies equally to a warrant for arrest; and neither search warrant nor an arrest with or without warrant can be made in any case without personal knowledge on the part of the official making application for a warrant, or the officer making the arrest without a warrant, of facts that would be competent in the trial of the offense before a jury.”

The court went on to say at page 565:

“None of the arresting officers—nor all of them together—had personal knowledge of sufficient evidence of probable cause to arrest appellant, that would have been admissible before a jury on a trial for the offense. The anonymous telephone conversation would not have been admissible. Rudd, the federal narcotics officer, could not have testified with respect to the description given to him by other persons of the man and truck at Standish at the day of the robbery of the stock of narcotics from the rug store at that city; and could not have testified that the man and the truck so described were identical to the man and truck he had seen some months before at the house on South Water Street. This would all have been hearsay—and poor hearsay at that, since the record of the trial discloses that Rudd testified that he ‘did not pay any attention to that truck or the man’ when he saw them. An arrest and

search on such flimsy pretext of evidence is in violation of the law. Furthermore, Rudd did not make the arrest nor was he present at the time. He was out of the state when the arrest of appellant was first considered, and also when it was actually made. All this information from Rudd was found in a file in the office of the bureau in Detroit. *An arrest and search without a warrant cannot be justified by an officer on information which he finds in a file which has been made up by someone else. He must have personal knowledge of facts showing probable cause.*" (Emphasis added.)

In

United States v. Clark (D. C., W. Dist. Mo., W. Div., 1939), 29 Fed. Supp. 138, 140,

the court stated:

"It seems to us that the Fourth Amendment to the Constitution, U.S.C.A., is whittled away to nothingness if it is held that a citizen may be arrested and searched without a warrant of arrest or a search warrant if only it is shown that some reliable informer has said the citizen has committed or is committing a felony, without any showing whatever (and there was none here) that the informer's information was itself more than mere guess-work and speculation."

See also:

Johnson v. United States (1948), 333 U. S. 10, 92 L. Ed. 436;

Wisniewski v. United States (6th Cir., 1931), 47 F. 2d 825 (which reached the conclusion that there was probable cause but at p. 826 questioned whether information received from an informant of known reliability in and of itself constituted probable cause for arrest without a warrant);

The means used to obtain the story from Martinez weaken the probability of its truthfulness and should have been so considered by the arresting officers.

As was trenchantly stated by the court in

People v. Bates (Oct. 2, 1958), Cal. App. 2d
....., 330 P. 2d 102, 106:

“Of course, coercion practiced on an informer is a factor affecting the credibility of the informer,
* * *”

Aside from Martinez’s story, Agent Spohr admittedly had no other information that appellant was violating any law [Tr. 157]. Agent Spohr’s testimony on this subject is very revealing. At page 157 of the Transcript, he was asked:

“Q. Had you ever seen Mrs. Martinez before that time? A. No, sir.

Q. Had you ever seen Mrs. Rodgers before that time? A. No, sir.

Q. Did you know anything at all about Mrs. Rodgers other than what Mr. Martinez had told you? A. No, sir.

Q. Your sole source of information, then, was Mr. Martinez? A. And facts that I assumed in my own mind, yes, sir.”

As this Honorable Court has heretofore stated in

Brown v. United States (9th Cir., 1925), 4 F. 2d
246, 247, *supra*:

“While an officer may arrest without warrant for reasonable cause, he can only act upon evidence; *he cannot act upon mere suspicion.*” (Emphasis added.)

It is the position of the appellant that the sole information upon which the officers assumed to arrest appellant

without a warrant was that coerced from Martinez, a man of poor reputation, previously unknown to the officers, and a man of unknown reliability; that, accordingly, no matter what the subjective good faith of the officers may have been they acted without probable cause in arresting appellant without a warrant.

In the court below, the government made claim that there was corroboration. At page 198 of the Transcript the Assistant United States Attorney stated:

“But beyond that, I think we have corroboration in this case. I think we have corroboration by the past narcotics record of the defendant Rodgers, which was checked up on. I think we have the \$2000 check, which corroborated what Mr. Martinez said—that is, that they returned to Los Angeles and got that check and went back to buy it. We have the women’s clothing in the trunk of the car, whereas Mr. Rodgers said that the women had stayed in Los Angeles and Mr. Martinez said they had come down to Mexico. I think that the Agent relied upon the fact that it is reasonable that if they had stayed in Los Angeles they wouldn’t have sent their clothing ahead to Mexico. We have the fact that when they went into the restaurant, before they made the arrest, Mr. Martinez was greeted by his wife and they appeared to know one another; that they stated what their names were, and that they stated that they had come from Mexico; that they had those Mexican baskets, which again the Agent could infer corroborated the fact that they had been in Mexico. We have the whole circumstances surrounding the situation, and in a sense it was all one transaction right there from the border. We have the corroborating fact that Mr. Martinez gave the names of undercover Agents in San Francisco with whom he worked and established that he had some experience as an

informant, which the Agent might have used to think that he was more credible. We had the story by Mr. Rodgers to the Agent that he was a breeder of horses and a trainer and that that is why he went down to Mexico and visited the racetrack each day but didn't meet anybody he knew."

Considering these contentions of corroboration seriatim, it will be seen that taken singly or collectively they constitute no corroboration at all:

First: It is claimed that the past narcotics record of the defendant Rodgers (appellant's husband), now deceased, affords corroboration. Rodgers, it is true, admitted a prior narcotics offense. The government claimed below that it was checked upon. This is not borne out by the record. The sole reference to checking on Rodgers' narcotics conviction is contained on page 136 of the Transcript, where Agent Spohr testified:

"* * * And I called 'Bud' Hawkins of the State Narcotics Bureau and asked him just more or less to verify Mr. Rodgers' 1932 arrest.

Mr. Seavey: '52?

The Witness: '52 arrest."

From the statement of the agent it is not apparent that he received any information from Hawkins which would indicate one way or the other whether Rodgers did, in fact, have a prior narcotics conviction. However, assuming *arguendo* that such information was provided, it is W. Rodgers (deceased), it has no application to appellant as it does not follow that the mere fact that her husband submitted that, while it may have materiality as to Evan band had a narcotics arrest five years previously indicates that she was engaged in the narcotics traffic.

Second: The fact that Rodgers had a \$2,000 check on his person is relied upon as corroboration of Martinez's story. It is respectfully submitted by the appellant that such a check is corroborative only of the fact that Rodgers possessed a considerable sum of money. The check was not introduced into evidence, and the only identifying reference to it was made by Agent Spohr at page 110 of the Transcript, where he said, speaking of Rodgers, "In his possession at the time was a Bank of America cashier's check for \$2000." It is urged by the appellant that this court may take judicial notice of the fact that the Bank of America is presently the largest banking institution in the world with branches throughout California. There is nothing in the record which would indicate that the check was, in fact, obtained from a Los Angeles branch of the bank and, accordingly, the mere possession of the check gives no credence to the story that Rodgers "returned to Los Angeles and got that check and went back to buy it."

Third: The government has claimed that the mere fact that the trunk of Rodgers' car contained woman's clothing corroborated Martinez's story—that "It is reasonable that if they had stayed in Los Angeles they wouldn't have sent their clothing ahead to Mexico" [Tr. 198]. This happenstance would be worthy of more weight had it been claimed by Rodgers that his wife was in San Francisco where they lived; however, it is admitted that the parties were traveling. His wife was, according to Rodgers, in Los Angeles roughly 150 miles away from the place where he was apprehended [Tr. 101-102]. It is not uncommon for persons traveling to remove only those clothes which are needed to meet their requirements and leave the balance in the car. In addition, there is nothing about the discovery of

woman's clothing in the trunk of an automobile which would lead one to believe that appellant, a person whose very existence was unknown to the agent, was, in fact, smuggling narcotics; nor does it appear from the record [Tr. 102-107] that the clothes were identified as belonging to appellant. The presence of the clothes was not corroborative of Martinez's story.

Fourth: The government claimed that the fact that prior to the arrest Martinez and his wife appeared to know one another when they met in the restaurant is somehow corroborative of his story. Certainly Mrs. Martinez would greet her husband when she met him and certainly Mrs. Martinez and appellant had every right to be in the restaurant. Their conduct there was innocent enough, it being stated at page 156 of the Transcript:

“What was Mrs. Martinez and Mrs. Rodgers doing? A. Sitting there drinking coffee.

Q. Just like anybody else? A. I guess so.

Q. Just like the rest of the people who were in the restaurant? A. Yes.

Q. There wasn't anything suspicious about what they were doing, was there? A. No, sir.

Q. It was a regular public restaurant that they were in? A. That is correct.”

Of interest in this respect is the language of the California Supreme Court in

Willson v. Superior Court (1956), 46 Cal. 2d 291,
294 P. 2d 36, *supra*,

wherein it was stated at page 295 of the California Report:

“Petitioner was found in the bar near the telephone where the informer had stated she would generally be. Since such innocent conduct could be known, however, to anyone who frequented the bar, it is doubtful

whether it was verification alone which would justify reasonable reliance on the additional information charging petitioner with bookmaking.”

This presents a different case from those in which the arrested person is found in some unusual circumstance or at some unusual place. Appellant submits that the mere innocent presence of a person in a public place engaged in the normal pursuits indigenous to that place can offer no corroboration to the story of an informer.

People v. Goodo (1956), 147 Cal. App. 2d 7, 304 P. 2d 776.

Particularly is this true in the instant case where the appellant was found in the Pickwick Hotel when Martinez had stated that she would be found in the Greyhound Bus depot.

Fifth: For some reason the government below seemed to feel that the fact that appellant and Mrs. Martinez stated their names when asked corroborates Martinez’s story. This is patently absurd. For the same reasons mentioned in the preceding paragraph, appellant contends that if the women had a right to be in the coffee shop they could presumably tell someone their names without corroborating their part in some crime.

Sixth: In the court below, the government put some stress upon the fact that the women stated that they had come from Mexico and that they had Mexican baskets, from which the agent could infer that they had been in Mexico. Assuming *arguendo* that Mexican type baskets are sold only on the Mexican side of the border, appellant respectfully calls to the attention of the court that these facts were noted and the answers received subsequent to the time of arrest [Clk. Tr. 48; Tr. 113, 159, 186]. On

page 113 of the Transcript the following appears in Agent Spohr's testimony:

"* * * I identified myself to both women as a Customs Agent and in the Customs Agency Service at San Diego and showed them my credentials, my commission.

Q. By Mr. Seavey: And then what did you say to them? A. I asked both women at this time if they would accompany me.

Q. Did you ask them about who they were at that point? A. Yes, we did ask their names, and they gave it as Mrs. Martinez and Mrs. Rodgers.

Q. And then what did you say? Tell us as best you can remember the exact words you used and what they said. What did you say next? A. The next words I asked, if both the ladies would accompany me, and they got up out of the booth and stated they had a check to pay, and as they walked toward the booth Agent Gates asked them, who had been right at my elbow, if they had just arrived from Mexico, and they said, 'Yes, a few hours before.' "

As heretofore pointed out, the actual arrest of appellant took place at the time of her submission to apparent lawful authority, viz., when she acquiesced in Agent Spohr's request to accompany him. It is axiomatic that information or evidence seized subsequent to the arrest can in no way bear on the probable cause that existed in the mind of the officer in making the arrest. The arrest itself serves as a cutoff point. If probable cause did not, in fact, exist at that time, subsequent discoveries cannot supply it. As the late Mr. Justice Jackson stated in

United States v. Di Re (1948), 332 U. S. 581, 92 L. Ed. 210, 220:

"The government's last resort in support of the arrest is to reason from the fruits of the search to

the conclusion that the officer's knowledge at the time gave them grounds for it. We have had frequent occasion to point out that a search is not to be made legal by what it turns up. In law it is good or bad when it starts and does not change character from its success."

Therefore, the fact that the women stated that they came from Mexico and that they had Mexican baskets in their possession could have no bearing, coming after arrest as it did, on the agents' state of mind at the time of the arrest. Moreover, as has heretofore been pointed out, at the time the two agents entered the coffee shop they had already decided to arrest appellant [Tr. 187].

Seventh: The Assistant United States Attorney below made reference to the fact that "We have the whole circumstances surrounding the situation, and in a sense it was all one transaction right there from the border" [Tr. 199]. It is in no wise clear to the appellant exactly in what manner the agents, upon entering the coffee shop, could have known that it was "one transaction right from the border"; nor for that matter is it clear to appellant exactly what was meant by this.

Eighth: It was urged below that the fact that Martinez gave the names of undercover agents in San Francisco with whom he worked somehow established that he had some experience as an informant which gave credence and reliability to his statements to Agent Spohr. (In this connection it should be noted that Martinez did not state that the agents with whom he had cooperated in San Francisco were undercover agents. At page 125 of the Transcript, Spohr stated that Martinez had informed him that "he had worked for the Federal Bureau of Narcotics in the past, and he named the Agents Casey,

Nicoloff, Sporosbouski and a few others I recognized the names.)

Appellant urges that the mere supplying of the names of agents in another city is by no means corroborative of a person's story. Martinez had already stated to Agent Spohr that he was awaiting trial for a violation of Section 11500 of the California Health and Safety Code, which would establish him as having had some contact with narcotics agents. However, it in no way establishes on which side of the law he contacted them. Nevertheless, assuming that Martinez had acted as a confidential informant for the Federal Bureau of Narcotics in San Francisco, this fact gave no corroboration to Agent Spohr in establishing probable cause. If the named agents themselves had talked to Agent Spohr and told him, "Yes, we know Martinez, and Martinez has worked with us and has proved reliable," this would be hearsay and not the personal knowledge of Spohr such as would warrant the formation of probable cause in his mind. The situation would not be unlike that presented in

Worthington v. United States (6th Cir., 1948),
166 F. 2d 557, *supra*,

in which the agents relied upon the contents of a file made out by another agent. In reversing that case for lack of probable cause, the Sixth Circuit stated, as heretofore quoted, page 565:

"An arrest and search without a warrant cannot be justified by an officer on information which he finds in a file which has been made up by someone else. He must have personal knowledge of the facts showing probable cause."

As stated by Judge McAllister in his dissenting opinion in
Gilliam v. United States (6th Cir., 1951), 189 F.
2d 321, 325, *supra*:

“Although the fact that evidence furnished an officer by an informer—if the officer considers him a reliable informer—may constitute probable cause for an arrest, nevertheless, it does not follow that an arrest is made by an officer with probable cause where he relies upon information which has been furnished him by another party who has received such information from an informer unknown to the officer making the arrest.”

If information from the named San Francisco agents that Martinez was reliable would not enable Spohr to form a valid opinion as to his reliability, how, indeed, can the self serving statement of Martinez furnish corroboration to his story such as would give Spohr probable cause to make the arrest without a warrant?

Ninth: The government in the court below counted as corroborative of Martinez's story the fact that Rodgers said that he was a horse breeder and that he visited the race track at Caliente but did not meet anybody he knew. Appellant doubts whether the negative circumstance of not doing something or not meeting someone can provide corroboration for Martinez's story that she possessed illegal narcotics. Appellant urges that it is not at all unusual for a person to drop by a race track to visit friends and not find anyone there he knows. The explanation on its face is an innocent one. As stated in

People v. Gale (1956), 46 Cal. 2d 253, 294 P. 2d
13,

at page 257 of the California Report:

“Even if it is assumed that the damaged condition of the car would justify the officers in stopping it

and questioning the driver (citing cases), when that questioning elicited an explanation wholly consistent with innocence, no basis was established for arresting defendant and searching him and his car.”

Nor, in the instant case, would the fact that Evan Rodgers failed to meet anyone he knew at the race track be probable cause to arrest his wife some thirty miles away for a narcotics violation.

In conclusion, on this point appellant submits that there was not a single iota of corroboration of the story given to Agent Spohr by Gilbert Martinez; that Martinez was not only an informant of unknown reliability and, in fact, completely unknown as to identity but was not a person of good repute upon whose story credence could be put. Furthermore, the fact that Martinez was confined and interrogated an unreasonable amount of time created a mental climate which was not conducive to a voluntary offer of cooperation. This was known by the agent and should have been considered by him. The uncorroborated statement of an informant of unknown reliability does not constitute probable cause for an arrest without a warrant. There was no probable cause to arrest the appellant.

III.

Certain of the Findings of Fact Are Not Supported by the Evidence.

In raising this ground of appeal, appellant is mindful of the semi sacrosanct position accorded findings of fact by reviewing courts. However, certain of the findings of fact made by the court below are clearly erroneous and have no support in the evidence. When an attack is made on the findings of fact, a reviewing court may, in reviewing the entire evidence, be left with a firm convic-

tion that a mistake has been committed and, if this be so, the finding may be reversed. This precept was stated by the Supreme Court in

United States v. United States Gypsum Co. (1948),
333 U. S. 364, 92 L. Ed. 746,

wherein it was stated at page 766 of the Lawyer's Edition of the United States Report:

"Since judicial review of findings of trial courts does not have the statutory or constitutional limitations on judicial review of findings by administrative agencies or by a jury, this Court may reverse findings of fact by a trial court where 'clearly erroneous.' The practice in equity prior to the present Rules of Civil Procedure was that the findings of the trial court, when dependent upon oral testimony where the candor and credibility of the witnesses would best be judged, had great weight with the appellate court. The findings were never conclusive, however. A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

United States v. Oregon State Medical Soc. (1952),
343 U. S. 326, 96 L. Ed. 978;

Gamerwell Company v. City of Phoenix (9th Cir.,
1954), 216 F. 2d 928;

Alaska Freight Lines v. Harry (9th Cir., 1955),
220 F. 2d 272.

In conformity to the mandate of Rule 18(d) of this court, appellant hereinafter states as particularly as may be wherein the complained of findings of fact are erroneous.

- (a) *The findings of fact that the court took judicial notice that it would occasion a delay of several hours to secure a warrant of arrest for appellant is not supported by the evidence.*

Appellant submits that that portion of Finding of Fact III [Clk. Tr. 47, lines 18-21], which states:

“The Court took judicial notice that if a judge or commissioner were found at home, the distances and traffic conditions would cause several hours delay if a warrant were sought”

is not supported at all by the evidence and, therefore, is clearly erroneous within the definition of

United States v. United States Gypsum Co. (1948),
333 U. S. 364, 92 L. Ed. 746, *supra*.

At the hearing below defense counsel attempted to establish that there were sufficient magistrates available so that the arresting officers should have attempted to get an arrest warrant prior to arresting appellant [Tr. 149-153]. The sole reference by the court made to the availability of judicial officers is contained at page 151 of the Transcript, wherein the court stated:

“* * * Let the record show, first, that the Commissioner lives in Point Loma, and that probably at best, if available at the home, it would be thirty minutes or more before she could be reached.”

This reference was made with respect to the Honorable Betty Graydon, United States Commissioner in San Diego. It does not purport to be judicial notice that any attempt to have a warrant issued by federal judge, state judge, or other judicial officer would necessitate a delay of several hours. The failure of the officers even to attempt to secure

a warrant is of paramount importance in a case of this type where probable cause for an arrest without a warrant is so obviously lacking. It appears to be well established in the federal judicial that, barring exceptional circumstances, a warrant for arrest should be obtained. It would appear under the facts of this case that the motivating reason for not securing a warrant was that it would be more inconvenient for the officers to do so rather than go directly to the bus station and make the arrest. The United States Supreme Court in commenting on this subject in

Johnson v. United States (1948), 33 U. S. 10, 92
L. Ed. 436, at 440-441,

stated:

“There are exceptional circumstances in which, on balancing the need for effective law enforcement against the right of privacy, it may be contended that a magistrate’s warrant for search may be dispensed with. But this is not such a case. No reason is offered for not obtaining a search warrant except the inconvenience to the officers and some slight delay necessary to prepare papers and present evidence to a magistrate. These are never very convincing reasons and, in these circumstances, certainly are not enough to by-pass the constitutional requirement.”

The point was made by Agent Spohr in testifying that he felt that “time was of the essence and the delay would be too great” [Tr. 153]. The basis for this statement is the fact that appellant was supposedly waiting in the bus station and would, if not immediately apprehended, take “the bus north” [Tr. 115]. Appellant contends that on the basis of Martinez’s information the appellant and Mrs. Martinez were to wait in the Greyhound Bus station

until Rodgers and Martinez picked them up [Tr. 107]. It is unreasonable to suppose that the slight delay necessitated for a warrant would have caused appellant to flee [Tr. 154].

In addition, this is not the classical type of emergency case where the suspected person is in an automobile or is in danger of vanishing into a crowd. As Agent Spohr stated at page 115 of the Transcript, he was afraid the women would take the bus north. Assuming that the women had left by the time Spohr arrived at the depot with his warrant of arrest, it would have been a simple matter to overhaul the bus which would have been proceeding north on a predetermined route and apprehend appellant. In these circumstances a finding that judicial notice was taken that several hours' delay would result from an attempt to secure a warrant works clear prejudice upon the appellant. The finding is not only erroneous it is also entirely unsupported. The agents had ample time to secure a warrant and by failing to do so violated appellant's rights under the Fourth Amendment.

(b) *The finding of fact that informer Gilbert Martinez told witness Spohr that appellant transported heroin across the border in her body cavity is not supported by the evidence.*

Appellant objects to that portion of Finding of Fact III contained on pages 46 and 47 of the Clerk's Transcript which states:

"Mr. Martinez then told Agent Spohr the following:

"* * * that on October 11, 1957, at about 1:00 p.m., Mrs. Rodgers and Mrs. Martinez returned to the United States on foot through the port of San Ysidro, with the Heroin concealed by Mrs. Rodgers in her body cavity * * *."

While it is true that appellant has stipulated [Clk. Tr. 56-57] that appellant brought into the United States from Mexico the powder contained in two rubber contraceptives and that said powder was found to be heroin, said stipulation does not relate back to the time prior to the arrest and so does not go to affect the probable cause which the agent had for arrest. The finding is unsupported in the evidence in that nowhere in the Transcript is there testimony by Agent Spohr that Martinez told him that Mrs. Rodgers did, in fact, cross the border with heroin in her body cavity or, for that matter, elsewhere on her person. The sole reference made to this part of the transaction by Martinez according to Agent Spohr is contained at pages 107 and 108 of the Transcript. According to Spohr, Martinez told him the following:

“* * * On Friday morning—they stayed over Thursday; Mr. Rodgers was rather tired—on Friday morning Mr. Rodgers *suggested* that his wife Nadine would conceal the heroin in her inner body cavity and carry it across the line afoot accompanied by Mrs. Martinez, * * *” (Emphasis added.)

At page 108, the court queried:

“* * * Did he tell you whether or not the two women, Mrs. Rodgers and Mrs. Martinez, did cross on foot into the United States?”

The Witness: Yes, sir, they had crossed two hours before they had come into the line.”

A perusal of the foregoing testimony reveals no statement by Martinez that appellant did in fact carry heroin across the international boundary. He states that it was suggested that she should and that she did, in fact, cross the boundary; but there is no statement that, when she did cross the boundary, she had acquiesced in her husband's

suggestion and had transported the heroin. Accordingly, the above quoted finding is totally without support in the evidence. If Agent Spohr were not informed that appellant had transported the narcotics across the international line, he would have no cause whatsoever to arrest appellant even if he could believe the story of Martinez. The finding of fact is of vital importance.

(c) *The finding of fact that there was corroborating evidence for the story of informer Martinez is not supported by the evidence.*

Appellant objects to that portion of Finding of Fact III contained on page 47, lines 13 and 14, of the Clerk's Transcript, which reads as follows:

"Both agents believed that Martinez and the corroborating evidence *evidence* * * *."

(This is obviously a typographical error and appellant construes it to mean that both agents believed Martinez and the corroborating evidence.)

Appellant objects to this finding in so far as it purports to hold that there was any corroborating evidence for the story of Gilbert Martinez. Appellant's view on this has been set forth at length under heading II above, page 13 *et seq.* Therefore, it would serve no useful purpose to reiterate the argument except to say that it is the position of the appellant that there is no corroboration whatsoever for the story of Martinez.

IV.

**Certain of the Conclusions of Law Are Not Well Taken
in Law, nor Are They Supported by the Findings
of Fact or by the Evidence.**

Appellant next urges upon this court the error of certain conclusions of law made by the trial court. The basic principles involved in appellant's objections to many of these conclusions have already been stated under headings II and III, *supra*, and, while appellant will not re-argue *ex extenso* points already covered, a brief summation will be made in those cases.

- (a) *The conclusion of law that Agents Gates and Spohr had reasonable grounds to believe that appellant had brought heroin into the United States is not supported at law, by the findings of fact, or by the evidence.*

Appellant objects to Conclusions of Law I [Clk. Tr. 50], which reads:

"Customs Agents Spohr and Gates had reasonable grounds to believe that on or about October 11, 1957, defendant NADINE E. RODGERS did knowingly import and bring into the United States of America from a foreign country; namely Mexico, a certain narcotic drug; namely, approximately 400 grains of Heroin, contrary to law. Both agents acted in good faith and believed the information supplied by Gilbert Martinez. * * *"

(The subjective good faith of the agents is not questioned. In fact, the good faith of Agent Spohr was stipulated.) [Tr. 120.] This point has heretofore been discussed under heading II, wherein appellant argued that the agents did not possess such information as would permit

them to have probable cause to arrest appellant without a warrant. Martinez, the informer who supplied all of the information the agents had, was a person unknown to the agents prior to their interrogation of him. The agents had had no prior dealings with Martinez which would establish his reliability as an informant who gave valid information. During the Martinez interrogation certain facts were brought out which would tend to discredit Martinez such as the fact that he was a heroin addict, was presently awaiting trial on a violation of the California Health and Safety Code. In addition, Martinez was subjected to a considerable amount of compulsion because of the protracted interrogation to which he was subjected and because of his prolonged confinement, all of which should have lessened the validity of his story in the eyes of the agents. Since there was no valid corroborating evidence for the story of Martinez, so that the story stood alone as a basis for probable cause, the conclusion of law that the agents had reasonable grounds to believe that appellant had brought heroin into the United States is not supported in law, by the findings of fact, or by the evidence.

- (b) *The conclusion of law that there was independent corroboration for much of Martinez's statement to the officers is not supported in law, by the findings of fact, or by the evidence.*

Appellant objects to the last line of Conclusion of Law I [Clk. Tr. 50], which reads: "There was independent corroboration for much of Martinez' statement to the officers." This has already been discussed at length in heading II, *supra*. The points of corroboration which were relied upon by the government below were the past

narcotics record of defendant Rodgers which, as appellant has previously pointed out, cannot be taken as reasonable cause to arrest his wife; nor is it corroborative of any of Martinez's story inasmuch as Martinez did not mention Rodgers' prior conviction.

The \$2,000 check carried by Rodgers does not corroborate the fact that the parties returned to Los Angeles inasmuch as the check is not in evidence and the testimony did not show whether it was on a Los Angeles branch of the Bank of America.

The fact that there was woman's clothing in the trunk of the car was corroborative of no portion of Martinez's story since it is susceptible of an innocent interpretation in that Rodgers admitted that he and his wife had come from San Francisco and that she was in Los Angeles. In any event, there is nothing in the testimony to indicate any relation between appellant and the clothes found in the car.

The fact that Martinez was greeted by his wife in a public restaurant certainly corroborates nothing since it is uniformly held that the mere fact that someone is lawfully in a public place where an informer says they will be (and here she was not in that place) is not corroborative of the informant's story. If the parties have a right to be in that public place, it is certainly not corroboration of the story if a husband and wife exchange greetings in that public place. For a like reason, the fact that Mrs. Martinez and appellant stated to the agents in response to their questions that they were, in fact, Mrs. Martinez and Mrs. Rodgers is noncorroborative of Martinez's story since, as it appears from the record, the women were lawfully in a public restaurant drinking coffee "just like anyone else." Certainly they would be ex-

pected to give their names to an officer who has identified himself as a customs agent and has requested their names. The fact that the women stated that they had come from Mexico and had Mexican baskets in their possession is not corroboration of Martinez's story since many people lawfully come from Mexico every day. However, determinative of this point is the fact that at the time these facts were ascertained the arrest had already taken place, and the initial unlawfulness of the arrest cannot be cured by the fruits of a search incident thereto.

The fact that Martinez gave the names of agents in San Francisco cannot be considered corroborative of his story since anyone admittedly in the narcotics difficulties that he was in might well know the names of narcotics agents in the same locality. In addition, under the holding of

Worthington v. United States (6th Cir., 1948),
166 F. 2d 557, *supra*,

probable cause cannot be based upon information supplied the arresting agent by another agent. In this case had the named agents from San Francisco themselves informed Spohr that Martinez was reliable as an informant, Spohr would not be justified in relying upon this in believing Martinez's story. This being so, it is submitted that the information supplied by Martinez himself cannot establish his own reliability. Reliability can only be established by the personal experience of the agent with the informant and here there was none.

Finally, the statement of Rodgers that he had met no one he knew at the race track cannot corroborate Martinez's story, for the way of the world indicates that, when people casually drop by to see friends without previous arrangement, the friends are often not there.

Based upon the foregoing, appellant objects to the conclusion of law that there was independent corroboration for much of Martinez's statement. There was no corroboration.

- (c) *The conclusion of law that Agents Gates and Spohr believed the information supplied by Gilbert Martinez is not consistent in law with a reasonable belief founded upon the findings of fact and upon the evidence.*

Appellant objects to that portion of Conclusion of Law I which states: "Both agents * * * believed the information supplied by Gilbert Martinez" [Clk. Tr. 50]. It is the position of appellant that such a belief is not reasonable under the law in the light of the facts of this case. The reasons for appellant's position have been thoroughly discussed under heading II and subheadings (a) and (b) of this heading (IV). Suffice it to say that there was no corroboration for Martinez's story. The story was coerced, and Martinez was an informant of unknown reliability. In the light of these facts, it was unreasonable of the agents to believe the information supplied by Martinez.

- (d) *The conclusion of law that the arrest of appellant was valid and legal is not supported in law by the finding of fact or by the evidence.*

Appellant objects to that portion of Conclusion of Law II [Clk. Tr. 50], which reads as follows: "The arrest of defendant NADINE E. RODGERS at San Diego on October 11, 1957, without a warrant was valid and legal." Inasmuch as appellant was arrested without a warrant, the arrest could only be valid and legal if made by the agents upon probable cause. As has been heretofore stated, the

arrest was predicated solely upon the uncorroborated information supplied by an informant of unknown reliability, and said information was coerced from said informant under circumstances which created a mental climate conducive to untruths rather than a true and voluntary statement. Appellant refers to the discussions of this point made in heading II and in the previous subheadings of this heading (IV).

- (e) *The conclusion of law enumerating the powers of arrest of treasury agents is not supported in law, by the findings of fact, or by the evidence in so far as it purports to conclude that the agents had reasonable grounds to arrest appellant without an arrest warrant.*

Appellant objects to Conclusion of Law II [Clk. Tr. 50] in so far as it purports to conclude that the agents had reasonable grounds to arrest appellant without a warrant. The arresting authority of the agents in question is derived from Title 26, U. S. C. A., Section 7607, which empowers them to—

“(2) make arrests without warrant for violations of any law of the United States relating to narcotic drugs * * * or marihuana * * * where the violation is committed in the presence of the person making the arrest or where such person has reasonable grounds to believe that the person to be arrested has committed or is committing such violation.”

There is no contention here that the violation was committed in the presence of the agents. In fact, appellant was sitting in a public coffee shop drinking coffee “just like anybody else”—“just like the rest of the people in the restaurant” and “there wasn’t anything suspicious about what they were doing” [Tr. 156].

The arrest of appellant, therefore, can only be justified under the second clause of the officers' authority, to wit: "Where such person has reasonable grounds to believe that the person to be arrested has committed or is committing such violation" (Title 26, U. S. C. A., Sec. 7607). As heretofore argued under heading II and the previous sub-headings of this heading (IV), the agents did not have probable cause to arrest appellant without a warrant.

- (f) *The conclusion of law that the agents had a right to search appellant following her arrest is not supported in law, by the findings of fact, or by the evidence and particularly is not so supported in so far as it purports to conclude that appellant's arrest was not unlawful.*

Appellant objects to that portion of Conclusion of Law III [Clk. Tr. 50], which reads: "The agents had a right to search NADINE E. RODGERS following the arrest; * * *" For the reasons heretofore stated, the agents did not have probable cause to arrest appellant without a warrant. Accordingly, the arrest was unlawful. The right of a legal search without a warrant exists only in so far as it is incident to a lawful arrest. Since the arrest was unlawful, the resulting search was unlawful and the fruits turned up by the search cannot retroactively validate the arrest.

United States v. Di Re (1948), 332 U. S. 581, 92 L. Ed. 210, 220.

(g) *The conclusion of law that no search was made of appellant, that the seizure of heroin from appellant was valid and legal, that the appellant agreed to surrender the narcotics, and that no unreasonable means were used is not supported in law by the findings of fact or by the evidence and particularly is not so supported in so far as it purports to conclude that the seizure of heroin from appellant was in any way made possible by a voluntary disclosure of said heroin by appellant to the arresting officer.*

Appellant objects to that portion of Conclusion of Law III [Clk. Tr. 50-51], which states:

“* * * However, no search occurred. The seizure of Heroin from NADINE E. ROGERS on October 11, 1957, at San Diego City Jail was valid and legal. The defendant agreed to surrender the narcotics. No unreasonable means were used.”

This conclusion is apparently based upon the facts which occurred at the San Diego City Jail when Agent Spohr gained possession of the narcotics in question from appellant. Agent Spohr testified on this point as follows [Tr. 116 *et seq.*]:

“Q. And as you walked down the corridor, did you observe anything that made you suspicious? A. Yes, sir, I did.

Q. What did you observe? A. As we got—as we were about halfway down the corridor, I noticed that Mrs. Rodgers had a kleenex which she was attempting to press in her left hand, attempting to conceal close to the skirt of her dress.

Q. Did you say anything to her? A. Yes, sir, I did. I asked her what she had in her hand and *I would like to see it.*

Q. What did she do? A. She opened her hand and showed the kleenex, and *I asked her to give it to me.*

Q. What did she do? A. She gave it to me.

Q. Did you examine what had been in her hand?

A. Yes, sir, I did.

Q. What was it? A. Upon opening the kleenex, there concealed was a rubber contraceptive with a white powder resembling heroin.

* * * * *

Q. Then did you say anything else to her? A. Yes, sir. My next remark was, 'Where is the rest of it?'

Q. What did she do? A. She reached in her brassiere inside her dress—I assume her brassiere, and extracted another kleenex.

Q. And what was in that kleenex? A. When that was opened, there was another rubber contraceptive containing a substance that resembled heroin." (Emphasis added.)

The comment of the court on this procedure is enlightening. At page 118 of the Transcript, the court stated: "Actually, you never made a search of her person?"

The conclusion of law is apparently founded upon the fallacious ground that there has to be actual force and violence used on a person in searching him in order to constitute a search. Appellant submits that this is not so. Appellant had been arrested and was held by the United States Customs Agents under their official authority. Can it be said that in such a case a person so held must resist search to the utmost of his physical abilities and, failing to do so, that said person has voluntarily disclosed the contraband thus waiving his rights under the Fourth

Amendment? Appellant contends that this question must be answered by this court in the negative. As stated by Judge McAllister in his dissenting opinion in

Gilliam v. United States (6th Cir., 1951), 189 F. 2d 321, 327:

“At that time he was as fully within their power and subject to their will as though they were seizing him and holding him until they found out what they wanted. I do not believe that a citizen has to risk trying to escape and being shot to prove that his actions under such circumstances are not voluntary.”

Appellant's position is supported by the Eighth Circuit in

Hobson v. United States (8th Cir., 1955), 226 F. 2d 890.

In that case government agents attempted an unlawful entry without a warrant into appellant's home. While certain agents were pounding on the front door, an agent stationed as a lookout at the rear of the house shouted, “ ‘He threw some “stuff” out of the window’ ” the “stuff” thrown out of the window proved to be contraband heroin. The trial court refused to suppress this evidence upon defendant's motion, saying—

“ ‘Well, I am afraid that when the defendant did that, whatever constitutional rights he had, he threw out the window with them, because that was a voluntary disclosure on his part of the possession of contraband, and officers of the law, like others, do not need to shut their eyes and look the other way when they see an offense being committed, * * *’ ”

In reversing the trial court, the Court of Appeals stated at page 894:

“Considering the total atmosphere of the case as directed by *United States v. Rabinowitz, supra*, we

can not separate the throwing of the package from the unlawful search. *The defendant's action in throwing the package was not voluntary but was forced by the actions of the officers.* That the officers anticipated such a result is evidenced by the fact that they stationed a man in the back yard to receive any person or evidence that might come out. *The throwing of the package was directly caused by the actions of the officers.*" (Emphasis added.)

It would be specious reasoning to say that merely because Agent Spohr did not touch appellant at the time he requested her to give him the heroin her act in turning over the heroin in response to his request constituted a voluntary disclosure of the evidence. The heroin was given to Spohr solely because appellant was held under the authority of the United States and was powerless to resist. The situation in which she found herself had its genesis in her unlawful arrest by the agents. Her act was compelled directly by the unlawful act of the agents. It cannot be regarded as a voluntary disclosure.

V.

It Was Error for the Trial Court to Refuse to Permit Appellant's Counsel to Examine the Report From Which Spohr Refreshed His Recollection While Testifying at the Trial.

Appellant's final point on this appeal is that error was committed by the court below when the court refused to allow appellant's counsel to examine a report from which Agent Clarence Spohr from time to time refreshed his memory while testifying. During the cross-examination of Agent Spohr, he made reference from time to time [Tr. 138-141, 145, 164, 165] to a report which he had made on the subject of his interrogation of Rodgers and

Martinez and upon the subsequent proceedings leading up to appellant's arrest. In order to further his cross-examination of Agent Spohr, Mr. Steward, appellant's counsel below, endeavored to examine the report in an attempt not only to develop contradictions between the report and the testimony but to test the witness' memory by ascertaining whether all the testimony given at the trial was contained in the report or whether the report contained some matters not brought out by the agent's testimony. This request was denied by the court and, although thrice renewed by Mr. Steward, the court was adamant in its refusal to allow examination of more than a single portion of the report. The testimony on this subject is covered at pages 165 *et seq.* of the Transcript:

"Mr. Steward: May I look at the other paper that he used to refresh his recollection?

The Court: On what matter?

Mr. Steward: The earlier one on the address and occupation of the Martinez'—not the occupation, but the address.

The Court: Do you have it there before you?

The Witness: No, sir; that is back in the file. It is the folded up piece of paper.

Mr. Seavey (handing document to the witness): Is this the one?

The Witness: May I see it? (A pause.)

Mr. Steward: Is that the one you previously used?

The Witness: Yes, it is.

Mr. Steward: May I see it, your Honor?

The Court: Let me look at it.

The Witness (handing document to the Court): The address is down at the bottom.

The Court: Mr. Steward. (Showing document to Mr. Steward.)

Mr. Steward: Are you just going to show me that portion of it?

The Court: Yes, that is what you wanted to see, the notes that showed the address and Martinez' place of employment.

Mr. Steward: I would like to see them all, your Honor.

The Court: I wouldn't be surprised you would.

Mr. Steward: Could it be marked, your Honor?

The Court: For identification?

Mr. Steward: Yes, your Honor.

The Court: It will be marked for identification and ordered sealed by the Clerk.

Mr. Steward: Very well, your Honor.

* * * * *

Mr. Steward: And also, your Honor, I would like to see the note that he looked at here to refresh his recollection as to the amount of money he had, which I think, your Honor, would be material, as one with a lot of money would probably be less likely to be involved in some illicit enterprise such as this than one without funds.

The Court: I don't think that follows. The request is denied.

Are you through with this witness?"

By this action the court prevented the appellant from examining a specified report from which appellant might very well have made telling cross-examination. Since the court ordered the exhibit sealed, we have no way of knowing whether or not this is true; but the opportunity should have been afforded to appellant to view the document and make the decision. The court acted in an arbitrary man-

ner by apparently deciding from its examination of the document in question that there was nothing therein which would aid the defense. It is submitted to this Honorable Court that the question of whether or not the contents of a document will prove of help to a defendant on cross-examining government witnesses is a matter for the defendant to decide and the sole function of the court, absent a declaration of government privilege, is to determine the legal propriety of the questions which examination of the documents prompts defendant to ask. The precise point is covered in the case of

Jencks v. United States (1957), 353 U. S. 657, 77 S. Ct. 1007, 1 L. Ed. 2d 1103,

wherein it was stated at page 667 of the United States Report:

“Every experienced trial judge and trial lawyer knows the value for impeaching purposes of statements of the witness recording the events before time dulls treacherous memory. Flat contradiction between the witness’ testimony and the version of the events given in his reports is not the only test of inconsistency. The omission from the reports of facts related at the trial, or a contrast in emphasis upon the same facts, even a different order of treatment, are also relevant to the cross-examining process of testing the credibility of a witness’ trial testimony.

“Requiring the accused first to show conflict between the reports and the testimony is actually to deny the accused evidence relevant and material to his defense. The occasion for determining a conflict cannot arise until after the witness has testified, and unless he admits conflicts, as in *Gordon*, the accused is helpless to know or discover conflict without inspecting the reports. A requirement of a showing of conflict would be clearly incompatible with our

standards for the administration of criminal justice in the federal courts and must therefore be rejected. For the interest of the United States in a criminal prosecution '* * * is not that it shall win a case, but that justice shall be done * * *.' *Berger v. United States*, 295 U. S. 78, 88, 55 S. Ct. 629, 633, 79 L. Ed. 1314.

"This Court held in *Goldman v. United States*, 316 U. S. 129, 132, 62 S. Ct. 993, 995, 86 L. Ed. 1322, that the trial judge had discretion to deny inspection when the witness '* * * *does not use his notes or memoranda* (relating to his testimony) in court * * *.' We now hold that the petitioner was entitled to an order directing the Government to produce for inspection all reports of Matusow and Ford in its possession, written and, when orally made, as recorded by the F.B.I., touching the events and activities as to which they testified at the trial. *We hold, further, that the petitioner is entitled to inspect the reports to decide whether to use them in his defense. Because only the defense is adequately equipped to determine the effective use for purpose of discrediting the Government's witness and thereby furthering the accused's defense, the defense must initially be entitled to see them to determine what use may be made of them. Justice requires no less.*" (Emphasis added.)

The court went on to decry the practice pursued by the trial judge below in examining the documents in order that he might determine whether in his mind the documents were relevant or material. At page 669 of the United States Report the court states:

"The practice of producing government documents to the trial judge for his determination of relevancy

and materiality, without hearing the accused, is disapproved. Relevancy and materiality for the purposes of production and inspection, with a view to use on cross-examination, are established when the reports are shown to relate to the testimony of the witness. Only after inspection of the reports by the accused, must the trial judge determine admissibility—e.g., evidentiary questions of inconsistency, materiality and relevancy—of the contents and the method to be employed for the elimination of parts immaterial or irrelevant. See *Gordon v. United States*, 344 U. S., at page 418, 73 S. Ct., at page 372.”

Appellant submits that the facts of the instant case bring it squarely within the rule of the *Jencks* case. The request to inspect was made during a cross-examination in which the witness had repeatedly referred to the report in question. The request was specific, relating to a certain report and not a general all-encompassing fishing expedition of the government’s files. From some of the answers of the witness and from the necessity of his constant reference to his file, it was apparent that, to paraphrase the *Jencks* case, time had dulled his treacherous memory. The court was on notice that counsel wished to inspect the documents since he thrice requested them and was rebuffed. Appellant should have been accorded the right to inspect the documents since appellant was the only one who could determine whether the contents thereof were material to the case. The trial judge engaged in a disapproved practice when he insisted on substituting his own judgment of materiality for that of the appellant. This was error.

Conclusion.

Recapitulating appellant's position, it is appellant's contention that her arrest was unlawful because the arresting officers, in arresting appellant without a warrant, acted without probable cause to believe that appellant had committed a crime. By so acting the officers violated appellant's constitutional rights guaranteed her under the Fourth Amendment of the Constitution. The arresting agents acted solely upon the story of Gilbert Martinez. They had never seen Martinez before. They knew nothing of his reliability, and they secured the information from him by coercive interrogation. It is established that the uncorroborated information of an informant of unknown reliability does not constitute probable cause for arrest without a warrant. There was no corroboration in this case. The prior narcotics conviction of appellant's deceased husband gives no probable cause as to appellant. There was no showing that the \$2,000 cashier's check in the possession of appellant's deceased husband in any way corroborated the story of Martinez that said check had been obtained in Los Angeles. The fact that there was woman's clothing in the trunk of the car belonging to appellant's deceased husband has an innocent explanation that appellant and her husband were at that time traveling from their home in San Francisco. Furthermore, nothing appears in the record which would connect the clothes found in the car with appellant. There is no corroboration from the fact that informant Martinez knew and greeted his wife in the coffee shop of the Pickwick Hotel. Appellant and Mrs. Martinez had a perfect right to be in said coffee shop. It was a public place and their presence there raised no admissible inference that appellant was committing a crime; nor does it furnish corroboration.

ration for the story of Martinez. This is a different situation from the one where an informant's testimony leads officers to find the accused person in some strange or unusual place where ordinarily he would not be. Martinez's story was not corroborated by the statement of the women that they had come from Mexico or their possession of Mexican baskets. Prior to the discovery of these facts, appellant had been placed under arrest. The subsequent discovery of these facts could in no way affect the state of mind of the agents at the time they made the arrest. Particularly is this true in light of the fact that the agents admitted that they had already decided to arrest appellant upon their entry into the coffee shop.

The validity of an arrest without a warrant is established by the state of mind of the officers at the moment of making the arrest and, if illegal at that time, cannot be made legal by reason of the fruits of the subsequent search.

The court below erred in certain of its findings of fact and conclusions of law. Most of these errors relate to the question of whether there was probable cause to arrest without a warrant and, accordingly, will not be further belabored here. There is no support, however, for the finding of fact that the court took judicial notice that an attempt to secure a warrant of arrest would necessitate a delay of several hours. Arrests without a warrant on probable cause are generally viewed with disfavor where there was time to obtain a warrant and the officers fail to do so.

The conclusion of law that no search was made of appellant is erroneous. The use of force in extracting contraband from an arrested person is not a requisite of a search. Submission to lawful authority and the request of the officers of the law constitute a search whether or

not the arrested person is physically compelled to yield the contraband. There was no voluntary disclosure in this case since appellant's action in turning over the contraband was compelled by the original wrongful act of the officers in arresting her without probable cause.

The trial judge erred in refusing to permit appellant's counsel to examine the report to which Agent Spohr repeatedly referred under cross-examination. It is not necessary that an inconsistency between the report and the testimony be shown as a prerequisite foundation to divulgence of the contents of the report to a defendant. The defendant in a criminal case is the sole person in a position to judge whether or not the material in a government file is material and relevant to his case. The trial court should have permitted appellant's counsel to examine the report of Agent Spohr to make this determination. By refusing three requests of appellant's counsel for specific documents and then by substituting the court's determination of materiality for the defendants', the court committed error.

Despite the fact that appellant admittedly was in possession of heroin and admittedly had unlawfully brought that heroin into this country, she is no less entitled to the protection of the United States Constitution. As has been repeatedly stated by our courts, the Constitution protects guilty and innocent alike. In the words of Judge Youngdahl in

United States v. Castle (D. C. D. C., 1955), 138
Fed. Supp. 436, 440:

"The peddling of narcotics is a singularly detestable and reprehensible crime. It is a widespread evil which widely corrupts and even destroys those it touches. It must be wiped out, but it must be wiped

out in a manner consistent with the protections our Constitution affords all people, innocent and guilty alike.”

In the premises, it is appellant's contention that this Honorable Court should reverse the judgment of conviction below and order the unlawfully seized narcotics suppressed.

Respectfully submitted,

HARRY D. STEWARD,

THOMAS H. LUDLOW, JR.,

Attorneys for Appellant.

No. 16020

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

E. NADINE RODGERS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

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No. 16020

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

E. NADINE RODGERS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

Jurisdictional Statement.

The jurisdiction of the District Court is founded upon Title 18, United States Code, Section 3231. An Indictment was returned by the Grand Jury, Southern District of California, Southern Division, in which Appellant and her deceased husband were charged in one count with the illegal importation of 400 grains of heroin, in violation of Title 21, United States Code, Section 174. Pre-trial hearing was had on a motion by Appellant to suppress evidence and findings of fact and conclusions of law were filed ordering the denial of the motion. Trial was thereafter waived and the case submitted upon stipulation between the parties. Judgment was rendered finding Appellant guilty and sentencing her to the custody of the Attorney General for a period of five years. Notice of Appeal was filed by Appellant and jurisdiction of this Court is invoked under the provisions of Title 28, United States Code, Sections 1291 and 1294.

Statement of the Case.

References designated "Tr." refer to the Reporter's Transcript and the references to "Clk." refer to the Clerk's Transcript.

On December 23 and 24, 1957, Appellant's Motion to Suppress Evidence came before the United States District Court for hearing, Judge James M. Carter presiding. The Court found the facts as follows: At about 3:00 p.m. on October 11, 1957, Evan W. Rodgers and Gilbert Martinez entered the United States from Mexico at the port of San Ysidro, California in an automobile owned by Evan W. Rodgers [Tr. 108]. The occupants of the car were detained for customs inspection [Tr. 99, 109]. Evan W. Rodgers admitted that he had a prior narcotics conviction [Tr. 100]. He had a cashier's check for \$2,000 [Tr. 110]. There was a suitcase in the trunk of the car which contained women's clothing and a legal document concerning the sale of real estate [Tr. 109, 177].

Beginning at about 4:00 p.m. on the same day Customs Agent Clarence A. Spohr, Jr., interviewed Mr. Rodgers about an alleged violation by Mr. Rodgers of Title 18, United States Code, Section 1407 [Tr. 98-99]. Mr. Rodgers told Agent Spohr the following:

That he was convicted in San Francisco in 1952 of conspiring to violate narcotic laws and was sentenced to three years imprisonment [Tr. 100]. That some short time before October 11, 1957, he left San Francisco for Tijuana with his wife, Nadine E. Rodgers and accompanied by Mr. and Mrs. Martinez; that he and Gilbert Martinez left their wives in Los Angeles and drove to Tijuana in order that Rodgers, a professional horse trainer, could visit friends at the race track; that a friend

named "Manuel" went along on the trip from San Francisco to Tijuana [Tr. 100].

At about 4:30 p.m. of the same day at San Ysidro, Calif., agent Spohr interviewed Gilbert Martinez [Tr. 102]. Mr. Martinez told Agent Spohr that he was then out on bail on a pending charge under Section 11500 of the Health and Safety Code of California [Tr. 124] and that his last injection of heroin was three days ago [Tr. 128]. Agent Spohr observed the marks of an addict on the arms of Martinez [Tr. 127]. He said that he was an informant for the Federal Bureau of Narcotics in San Francisco [Tr. 125, 171], and named several agents with whom he had worked [Tr. 125]. All of the names were familiar to Agent Spohr as names of agents who he knows are working in the San Francisco area [Tr. 125]. Martinez requested that he not be prosecuted for what he would tell Agent Spohr. Spohr said that the decision rests through the United States Attorney but that he was quite positive the United States Attorney would go along with anything along those lines [Tr. 143]. Mr. Martinez then told Agent Spohr the following: That Mr. and Mrs. Evan Rodgers, Mr. and Mrs. Gilbert Martinez and Manuel Garcia left San Francisco together on October 6, 1957, in order that Evan Rodgers could purchase heroin through a connection of Garcia's in Tijuana [Tr. 103]. That the five of them arrived in Tijuana on October 7, 1957, where Garcia located his Mexican connection "Red"; that Garcia alone purchased heroin at that time as Rodgers said that his money was tied up in a check [Tr. 104]; that they all returned to Los Angeles where Evan Rodgers cashed a \$3,200 check, taking \$1,200 in cash and a cashier's check for \$2,000; that Garcia absconded with \$600 of Evan Rodger's money on the pre-

tense that he would buy heroin for Rodgers in Los Angeles [Tr. 105]; that Mr. and Mrs. Rodgers and Mr. and Mrs. Martinez again went to Tijuana on October 9, 1957, where Rodgers contacted "Red"; that on October 10, 1957, Evan Rodgers purchased two rubber contraceptives full of heroin [Tr. 106]; that on October 11, 1957 at about 1:00 p.m. [Tr. 115] Mrs. Rodgers and Mrs. Martinez returned to the United States on foot through the port of San Ysidro with the heroin concealed by Mrs. Rodgers in her body cavity [Tr. 108, 114, 171, 172]; that the women were then to travel by bus to Tijuana and wait at the bus depot until the men arrived in the automobile [Tr. 107]; that Evan Rodgers and Gilbert Martinez crossed the border at about 3:00 p.m. where they were detained by customs inspectors [Tr. 108]; that the women could be found at the Greyhound bus depot at San Diego with the heroin concealed in Mrs. Rodgers' body [Tr. 172]; that Martinez would lead Agent Spohr there and point out the women [Tr. 107, 172].

At about 6:00 p.m. on the same day Customs Agent Walter A. Gates entered the room where Customs Agent Spohr was interviewing Gilbert Martinez [Tr. 171]. Both agents believed Martinez and the corroborating evidence [Tr. 120, 175]. The agents decided to arrest Nadine E. Rodgers [Tr. 187]. They didn't attempt to obtain a Warrant of Arrest because "time was of the essence" [Tr. 114]. Agent Spohr anticipated that if more time elapsed the women would worry that something had happened and would take the bus north [Tr. 115]. The Court took judicial notice that if a judge or commissioner were found at home the distance and traffic would cause several hours delay if a Warrant were sought [Tr. 151, 153]. Accordingly, Agents Spohr and Gates immediately started

for San Diego in separate cars [Tr. 111, 172]. Agent Spohr and Gilbert Martinez went to the Greyhound bus depot in San Diego and waited for Agent Gates in the rear parking lot [Tr. 111]. Meanwhile, Agent Gates took Evan Rodgers to the San Diego City Jail where Rodgers was booked on Title 18, United States Code, Section 1407. Gates then joined Spohr and Gilbert Martinez at the parking lot of the bus depot [Tr. 172].

At about 7:00 p.m., October 11, 1957, Gilbert Martinez accompanied by Agents Gates and Spohr, walked to the Greyhound bus depot at San Diego [Tr. 112, 173]. Gilbert Martinez saw his wife and Mrs. Rodgers drinking coffee in a booth at the coffee shop of the Pickwick Hotel, adjacent to the bus depot [Tr. 112, 173, 180]. Mr. Martinez entered the coffee shop and walked up to the booth alone. Both women greeted him [Tr. 112]. His wife stood up, held his arm, and they talked together for several moments [Tr. 112, 173, 182]. Agents Gates and Spohr came up and identified themselves as agents of the Treasury Department [Tr. 112, 133]. The women were asked their names and they said that they were Mrs. Rodgers and Mrs. Martinez [Tr. 112, 186]. Agent Spohr asked the women if they would accompany him [Tr. 112, 186]. They started to get out of the booth and said they had a check to pay [Tr. 112]. Agent Gates noticed that one of them held a straw shopping bag of the kind ordinarily seen and bought in Mexico [Tr. 174]. He asked what they had brought with them from Mexico and one said only a pair of shoes and a straw hat [Tr. 174]. On the way to the cashier's booth Agent Gates asked the women if they had just arrived from Mexico. They answered, "Yes, a few hours before" [Tr. 113]. After the check was paid and on the way out the door Mrs.

Rodgers asked, "Well, where are we going?" Agent Spohr said, "You are going to the San Diego City Jail. You are under arrest" [Tr. 114, 185]. The agents did not threaten the women nor did they use any force to have them come along to the police station [Tr. 114]. Agent Spohr and Agent Gates then drove Mr. and Mrs. Martinez and Mrs. Rodgers to the San Diego City Jail [Tr. 115, 175].

At the San Diego City Jail, Agent Gates kept Mr. Martinez in the booking office [Tr. 116, 175]. Agent Spohr escorted Mrs. Rodgers and Mrs. Martinez toward the female detention quarters [Tr. 116, 175]. As they walked down the corridor Agent Spohr saw that Mrs. Rodgers held a Kleenex in her left hand and was concealing it against her skirt. He said, "What have you got in your hand?" [Tr. 116]. Mrs. Rodgers showed him the Kleenex and he said "Give it to me" [Tr. 117]. Mrs. Rodgers handed over the Kleenex without protest [Tr. 117]. In the Kleenex was a rubber contraceptive which contained a white substance similar to heroin [Tr. 117]. Agent Spohr then said, "Where is the rest of it?" [Tr. 117]. Mrs. Rodgers reached into her bra and produced another folded Kleenex which also held a rubber contraceptive containing a white powder like heroin [Tr. 117]. Mrs. Rodgers' only other words were "That's all I got" [Tr. 118]. Agent Spohr did not threaten Mrs. Rodgers nor did he use any force in recovering the heroin [Tr. 118].

No claim was made by Mr. Rodgers by affidavit or otherwise to the heroin in Mrs. Rodgers' possession. Mrs. Rodgers by affidavit set forth the date of her marriage to Mr. Rodgers and alleged that all property owned by them was community property.

ARGUMENT.

I.

The Constitution of the United States Prohibits Only Searches and Seizures Which Are Unreasonable.

The Fourth Amendment to the Constitution provides in effect that all persons shall be secure not only in their persons but in their property and effects and shall be free from searches and seizures which are unreasonable. It is important to note that not all searches are prohibited by this amendment but only those which are "unreasonable." *Carroll v. United States*, 267 U. S. 132, 147 (1925). Stated another way, this amendment protects persons against officers acting on "whim, caprice or mere suspicion." *Brinegar v. United States*, 338 U. S. 160, 177 (1946). The test by which the actions of officers in making a reasonable search or seizure has been often stated. The rule is that before officers may conduct a search or seizure incident to an arrest there must be probable cause for such action. "Probable cause exists where 'the facts and circumstances within their (the officers) knowledge and of which they had reasonably trustworthy information (are) sufficient in themselves to warrant a man of reasonable caution in the belief that an offense has been or is being committed.'"

Carroll v. United States, 267 U. S. 132, 162,
supra;

Brinegar v. United States, 338 U. S. 160, 175,
supra;

Blackford v. United States, 247 F. 2d 745, 749
(9th Cir. 1957);

United States v. Walker, 246 F. 2d 519, 526 (7th
Cir. 1957).

In *United States v. Walker, supra*, the Court considered a new factor, the Narcotic Control Act of 1956, Title 26, United States Code, Section 7607, under which power is conferred upon officers of the Customs and others to “. . . make arrests without warrant for violations of any law of the United States relating to narcotic drugs . . . where the violation is committed in the presence of the person making the arrest or where such person has reasonable grounds to believe that the person to be arrested has committed or is committing such violation.” (70 Stat. 570.) The Court states that probable cause and “reasonable grounds” are concepts having virtually the same meaning.

II.

Under the Facts of This Case as Adduced During the Hearing on the Motion to Suppress, the Trial Judge Did Not Err in His Conclusion That the Officers Had Reasonable Grounds for Their Actions.

An examination of the rule quoted before indicates that the question of whether or not probable cause exists is essentially a factual inquiry and no fixed formula can be arrived at. The test is reasonableness under all the circumstances and that depends upon the facts and circumstances of each case.

United States v. Rabinowitz, 339 U. S. 56, 63 (1950);

Rocchia v. United States, 78 F. 2d 966, 969 (9th Cir. 1935).

Although every case must be decided on its own particular facts this Honorable Court's attention is respectfully

invited to the following authorities wherein there was found to be probable cause:

Brinegar v. United States, supra;

Carroll, et al. v. United States, supra;

Williams v. United States, 160 F. 2d 125 (8th Cir. 1958);

United States v. Walker, supra;

United States v. Paradise, 253 F. 2d 319 (2nd Cir. 1958);

Blackford v. United States, 247 F. 2d 745 (9th Cir. 1957);

United States v. Hamm, 163 Fed. Supp. 4 (1958);

People v. Holguin, 145 Cal. App. 2d 520 (1956);

Willson v. Superior Court, 46 Cal. 2d 291 (1956).

On October 11, 1957, when Customs Agents Spohr and Gates arrested appellant at San Diego, California, the agents had knowledge of the facts adduced at the hearing on motion to suppress [Clk. Tr. 44 *et seq.*].

Probable cause in this case arose from the detailed information given the officers at the border and their observations of facts and circumstances both at San Ysidro and up at San Diego. The combination of these two sources of knowledge was sufficient to warrant the officers in the reasonable belief that a narcotic offense had been and was being committed by appellant. In arriving at such belief, the officers acted as reasonably cautious men.

On October 11, 1957, Evan Rodgers, appellant's husband, and Gilbert Martinez entered the United States from Mexico in Mr. Rodgers' automobile. Shortly there-

after both men were detained by Custom agents at San Ysidro for possible failure to register as a previously convicted felon on a narcotics charge, in violation of Section 1407 of Title 18, United States Code. Agent Spohr interrogated each of them, commencing with Mr. Rodgers *alone* at approximately 4:00 P.M. Thereafter, Agent Spohr questioned Martinez *alone* beginning at about 5:00 P.M. on the same day [Tr. 98, 99, 102]. *It is obvious from the transcript that Martinez and Rodgers did not have a chance to get together on their stories while being interrogated by the Customs agents.*

Mr. Rodgers admitted that he had been convicted in San Francisco in 1952 of conspiring to violate narcotic laws and sentenced to three years imprisonment. Martinez admitted to the agent that he was out on bail from a pending state charge of a violation of Section 11500 of Health and Safety Code, but had stated he had had no prior narcotic conviction. That charge involved an alleged possession of narcotics [Tr. 124-125]. *The agent noticed marks on Martinez's arms which were the marks of a heroin addict* [Tr. 127]. Martinez further told Spohr that the last time he had used a narcotic was three days prior to the interrogation. Both of the occupants of the car had failed to register under Section 1407 of Title 18, United States Code, when they entered the United States on October 11, 1957.

Mr. Rodgers stated that he and appellant had left San Francisco for Tijuana *with Mr. and Mrs. Martinez* and a *fifth person named Manuel*. He, Mr. Rodgers, further claimed that the two wives were in Los Angeles at that time, *which statement was later shown to be false* by finding Mrs. Rodgers and Mrs. Martinez at the bus station in San Diego, and that the men had gone to Tijuana so

that Rodgers could visit friends at the racetrack. He went on to say that he was a professional horse trainer but that he had located no one he knew at the track. Mr. Rodgers also stated that after they got to Mexico, Manuel had "*cut out*" and he did not know what had happened to him.

The agents found *a suitcase containing women's clothing* in the trunk of the car. Mr. Rodgers was also carrying *a cashier's check for \$2,000.00*. Mr. Rodgers admitted that the check was his and told Spohr "something about selling property." Rodgers was thereafter booked in the San Diego County Jail for a violation of Section 1407, failure to register [Tr. 148].

As indicated above, an interview was had with Martinez directly after the interrogation with Rodgers. Martinez was told by agent Spohr, as was true in the case of the interview with Rodgers, that he was entitled to counsel through all proceedings and that anything he said could be used against him in the future. After Martinez had been in custody several hours, he asked Agent Spohr about the government *not prosecuting Martinez if the latter told Spohr about Mr. and Mrs. Rodgers*. The agent advised Martinez that they would see the proper authorities, the United States Attorney, about that but that "the authority was not mine to say." He told Martinez that the decision would rest with the United States Attorney and added that he was positive the United States Attorney would go along with anything "along those lines." The request from Martinez also involved *freedom from prosecution as far as his wife was concerned* [Tr. 142-143]. Spohr then told Martinez that he was positive *the latter and his wife would be used as material witnesses in the matter*. Although Agent Spohr did not tell Martinez that unless Martinez told him about Rodgers and his

wife that Martinez would be prosecuted as a user of narcotics who had failed to register, it is obvious that *Martinez was apprehensive about his status* in that respect [Tr. 143-144].

During the rest of the interview with Gilbert Martinez, the officers received essentially the following information: that appellant and her husband, along with Mr. and Mrs. Martinez, and *Manuel Garcia* had left San Francisco on October 6, 1957 for the purpose of acquiring heroin in Tijuana. That after a first trip to Tijuana they all returned to Los Angeles where Mr. Rodgers cashed a large check. They all went back to Tijuana a second time where Rodgers acquired heroin through a peddler named "Red." At about 1:00 on October 11, 1957, appellant accompanied by Mrs. Martinez returned to the United States on foot through the port of San Ysidro *with the heroin concealed in Mrs. Rodgers' body cavity*. The women were to travel by bus to San Diego and wait for the men at the Greyhound Bus Depot before departing to San Francisco. Gilbert Martinez also told the agent that he had worked as an informant for the Federal Bureau of Narcotics in San Francisco and *named several agents known to Mr. Spohr* with whom the latter had worked. As will be seen from the transcript and the Findings of Fact filed by the Court, *Martinez made a detailed and comprehensive statement of the circumstances* surrounding the various trips made by the men and their wives and Manuel to Tijuana and back to Los Angeles.

As stated above, it appears that the interrogation of Gilbert Martinez commenced at about 5:00 P.M. [Tr. 102]. When the questioning was finished, it was at a time when most law enforcement agencies, both federal and local at San Diego, would have been closed. However, Agent Spohr was able to check some local records

in San Diego, finding that Martinez had been involved in a minor infraction of the law with that police department. Since he had no information as to any particular prior offense committed by Martinez, it was obviously then impossible for the agents to check much further to determine if he had a prior record. However, since Agent Spohr did have specific information with respect to Rodgers' prior narcotic conviction, he called one "Bud" Hawkins of the State Narcotics Bureau and was able to contact him. The testimony was that Spohr asked Hawkins just more or less to "verify Mr. Rodgers' 1952 arrest." The reasonable inference from that testimony is that the person he had telephoned did verify the prior conviction [Tr. 136].

As stated above, it is clear that each case must be resolved on its own factual situation. Although the fact that this transaction occurred at the Mexico-California border did not *per se* give the officers probable cause to effect an arrest of the appellant, it is submitted that this circumstance is one of the factors to be considered with the others in determining the issue. As announced by this Honorable Court in *Blackford v. United States, supra*, at page 752:

"The Court will take judicial notice of the fact that the Mexico-California border is one of the major centers for the importation of narcotic drugs into the United States. Moreover, we are told in the record that between 18 and 20% of international traffic of narcotics in this area is conducted by smuggling the drugs in various body cavities. One need only read the daily newspaper to recount the horror, harm and hardship that these drugs produce. The problem of detecting and putting to an end this source of supply and of doing it effectively is one of great magnitude

and importance to the American people. It is a task which daily confronts law enforcement officers along the border.”

As the record shows, both Agents Spohr and Gates at the border talked at length with Gilbert Martinez and were convinced that he was telling the truth. It is important to keep in mind that *they had ample opportunity to observe his demeanor* since the interview was conducted personally, not over the telephone. It is felt that great weight should be given to this evaluation of the officers who are experienced in such matters by reason of their duties at the border, “one of the major centers for importation of narcotic drugs into the United States.” At the time of the interview they exercised the same type of judgment of his credibility as a court or jury would bring into play in determining whether a witness on the stand is reporting events truthfully. In addition to the officer’s opportunity to observe Martinez and question him, at length the government submits that Martinez’s obvious state of mind as to his own position at that time was a most significant factor in determining whether the officers were justified in believing that he was relating the events accurately. After sitting around a couple of hours before he was questioned by the agents, Martinez had ample time to consider the precarious position in which he found himself. The needle marks on his arms would show the the officers that he was a narcotic user and it was obvious that he had failed to register as required by law. He was out on bail on a narcotics charge. At that time he thought he could be prosecuted for something because he asked Spohr about not being prosecuted if he told the agent about Mr. and Mrs. Rodgers’ activities. It is clear that *Martinez was also worried about his wife* since his request involved a freedom from prosecution as far as she was

concerned. Although he did not indicate that she had smuggled any heroin, he was concerned about her possible involvement in the matter. Although officer Spohr told Martinez that he was positive the United States Attorney would go along with "anything along those lines," he still said that "the authority was not mine to say." Thus, in Martinez's mind there was still a possibility of a prosecution. Further, Spohr definitely told Martinez and his wife that *they would be used as material witnesses* in the matter.

For the above reasons, the agents were legally justified in believing that Gilbert Martinez had a compelling motive to relate the true facts. Being in custody for failing to register and hoping for the dismissal of any charges that might be lodged against him or his wife, Martinez, in any reasonable light, *would certainly have avoided giving false information for fear of making his position worse*. Erroneous information implicating innocent people and leading the customs agents on a "wild goose chase" could only, in his mind, have gotten him into more serious trouble with both customs and the authorities handling the other narcotics case in which he was then involved. See *United States v. Paradise, supra*, where an arrest without warrant was based upon information from narcotics addicts. The Court stated: "As a matter of fact the arrest was not illegal in view of the information in possession of the agents which led to the arrest." See also: *Williams v. United States, supra*, where an arrest without warrant was based upon information from persons held in custody by the police.

Not only was Martinez's position precarious, as he well knew, but it might be pointed out that the fact both men had failed to register under Title 18, United States Code, Section 1407 would have indicated to some degree to the

agents that they were afraid to call attention to themselves. That being true, this fact was one more point, although a small one, which added to the corroboration of Martinez's story.

Not only did the officers realize that Gilbert Martinez had a very good motive to tell the truth during the interrogation, but *he told a full and comprehensive story of the transactions*. In other words, it was not an anonymous "tip" from an identified source where the officers had no opportunity to place responsibility for an untrue allegation. It was not a bit of brief information from a source where the officers failed to interrogate the informant for any great length of time. Martinez was telling them the story *in the role of an eyewitness to the events* which he was relating. He gave all of the details, the times and the dates when the various parties left their destinations or arrived at certain places. He related the various activities of all the persons involved during the time the events were occurring. The information which he gave to the agents could hardly have been related in more detail. And he normally would have been used as a witness in Court against appellant and her husband.

In *Reyes v. United States*, 258 F. 2d 774, 784 (9th Cir. 1958):

"This Court has taken and will again take judicial notice (as did the court below) of the great public danger that there will be attempts to smuggle such drugs into the country every time an addict or user crosses the boundary line [footnote 9, p. 785.] 'Narcotic offenders are generally *recidivistic* in that the addict by definition is engaged in a course of *repetitious behavior* and those engaged in selling narcotics are predominantly either professionals or addicts.'" (Emphasis ours.)

The agents had seen the marks on the arms of Mr. Martinez that showed he was an addict and had had past experience with narcotics. Thus, they could correctly assume that he did have an awareness of the specific contraband involved. Martinez further admitted that he was on bail for a state narcotic charge, which was not unbelievable because of the marks on his arms. Further Rodgers had actually been convicted of a 1952 narcotic offense. If this Honorable Court has taken judicial notice of the fact that there will be attempts to smuggle such drugs into the country every time an addict or user crosses the boundary line and that most narcotic offenders are generally recidivistic in that the addict by definition engages in a course of repititious behavior, it is felt that the agents had the right to come to the same conclusion at that time. In fact, they were men who were working at the border with that very problem constantly at hand and were even more familiar with the situation than those of us who hear about it in the courts of law.

Appellant appears to contend that because many of the corroborating circumstances were not criminal acts *per se*, they cannot be used to legally justify the agent's belief in Martinez's story. However, it is submitted that circumstances and information used to corroborate an informant's narrative of events leading up to a crime need not be in themselves criminal acts. They only need be sufficient to establish the trustworthiness of his story. In the *Brinegar* case, *supra*, the court on page 175 commented as follows:

"In dealing with probable cause, however, as the very name implies, we deal with probabilities. *These are not technical; they are factual and practical considerations of everyday life* on which reasonable and

prudent men, not legal technicians act. The standard of proof is accordingly correlative to what must be proved."

In the case at hand, not only were the agents aware of Rodgers' past narcotic conviction and Martinez's heroin addiction, as well as the latter being out on bail on a state narcotics charge, but many of the facts which Martinez gave them proved to be correct. This was true even though Martinez had had no opportunity to get together with Rodgers on his story. Thus, not only were Rodgers and Martinez persons who were in the "recidivistic" class but Martinez's narrative held together in many of its details. It proved to be trustworthy. Before the agents even talked to Martinez, Mr. Rodgers had admitted to them that he and Martinez had left San Francisco for Tijuana with their wives. Thus, the agents knew that Martinez had been along on the trip from San Francisco and had been in a position to know the information he related. Rodgers also divulged that a fifth person named Manuel had gone along on the trip and stated that he had "cut out" and did not know what happened to that person. Martinez likewise told the agents that a fifth person named Manuel had been along on the trip and related the story about Rodgers getting "taken" for \$600.00 by Manuel, purportedly for a heroin purchase. Thus, Rodgers own admission that Manuel had "cut out" corroborates to some extent Martinez's story of the theft. Martinez also told the agents that Rodgers had received a check in the process of the transaction for \$2,000.00. This check was found in Rodgers effects. Not only did the finding of the check substantiate Martinez's narrative, but it was not unrealistic for the officers to assume that a person in possession of a large sum of money, who had been previously convicted of a narcotics offense and was

returning from Mexico, might well be involved in a narcotics transaction. The heroin marks which were found on Martinez's arm and which added substantial corroboration to this story have been discussed above. Martinez also told the agents that he worked as an informant for the Federal Bureau of Narcotics in San Francisco and named several agents known to officer Spohr as persons with whom in the past he had worked. Although Spohr did not attempt to check that information further, the hour having grown late past usual business hours, and time being of the essence in his opinion, the fact that Martinez named actual persons is still a consideration which Spohr could use in determining whether or not Martinez was telling him the truth. In other words, that information added something to the weight of all the other factors which legally justified Agent Spohr in effecting appellant's arrest.

Although Mr. Rodgers had stated that the wives were in Los Angeles, appellant staying with her sister [Tr. 98-102], the agents found a suitcase containing women's clothing in the automobile. Certainly this was sufficient to throw grave doubt upon the assertion of Rodgers that his wife was in Los Angeles rather than at the bus station where Martinez claimed she would be. It would have been *unlikely* that the clothing would have been left with Mr. Rodgers and Martinez if the women had been in Los Angeles as Mr. Rodgers claimed. As a matter of fact, Martinez's statement about the women was proven to be true, *by locating them at the bus station* where he said they would be. Appellant's Opening Brief at page 6 attempts to show that "contrary to Martinez's information, appellant and Mrs. Martinez were not there." However, a reading of the transcript shows that that statement is misleading, since the women were in San Diego at a

coffee shop *adjacent to the bus station* [Tr. 112]. They were identified as Mrs. Rodgers and Mrs. Martinez before even appellant claims she was arrested. This item of corroboration was most important as far as the agents were concerned since *Rodgers had obviously attempted to conceal the whereabouts of his wife* whom Martinez had stated carried heroin across the border in her body cavity. This circumstance in itself establishes to a great extent the reliability of Martinez's information. See *People v. Holquin, supra*, wherein the court states:

“The appearance of the appellant at the bar coincided exactly with the description given by the informer and that in and of itself was some evidence of the reliability of the information provided by the informer.”

This case is distinguished from those in which there is a question of the identity of a suspect and innocent persons are subject to arrest because of a vague description fitted to a wrong person. Appellant's presence at the Greyhound Bus Depot fitted Mr. Martinez's story of the separate border crossing by the men and women. It is submitted that at the time the women were identified as Mrs. Rodgers and Mrs. Martinez, the officers had sufficient information to constitute legal probable cause to arrest appellant. In other words the agents were, up to that time, justified in believing Martinez's story that appellant had crossed the border with heroin in her body cavity. Thus, it would appear to be unnecessary to determine the question as to when the arrest took place. However, in the event the court wishes to consider that question, appellee will address itself to the issue briefly. It was not until the two women were on their way out the door or perhaps outside of the building that Agent Spohr stated: “You are under arrest.” It is the appellee's position that the arrest did not occur until that time. It should be noted that

when the agents went up to the booth where Mrs. Rodgers and Mrs. Martinez were seated, they merely identified themselves as customs agents, showing their credentials. At about that time Agent Spohr asked both women "if they would accompany" him. Appellant's statement at page 6 of her brief that "Spohr informed them that they would have to accompany him" is somewhat misleading. Agent Spohr himself testified on two different occasions [Tr. 113-159] that he asked the women "if both the ladies would accompany" him and "if they would come with us." Agents Gates testified on the same subject [Tr. 186]. However, then it was counsel for appellant who in his question said, with reference to what Agent Spohr had told the women, "* * * did he then say, 'you'll have to go down to the police station,' " Agent Gates answered "As I recall." However, the court in its findings of fact stated [Clk. Tr. 48] that "Agent Spohr asked the women *if* they would accompany him." (Emphasis ours.) It is obvious that the women did not understand that they were under arrest since Mrs. Rodgers stated "Well, where are we going?" [Tr. 113]. It was only at that point that Agent Spohr told her she was going to the San Diego City Jail and she was under arrest. Of course, if the arrest occurred at the time Agent Spohr told Mrs. Rodgers that she was under arrest, then the agent had the right to consider the additional corroboration of the fact that at least one of the women told the agents they had just arrived from Mexico a few hours before and they possessed a handbag of the type commonly sold in Tijuana. It might be noted that in connection with the statements of one or both of the women about having just arrived from Mexico and possessing a type of handbag which is commonly seen and sold in and about Tijuana, the transcript does not appear to show that the two agents did *not*

see the Mexican handbag at the time they came up to the cafe booth and identified themselves. In fact, a reasonable inference would be to the contrary, that is, that the agents were able to see the handbag when they came up to the booth. At any event, it is submitted that the arrest occurred at the time Agent Spohr stated that appellant was under arrest and not beforehand. The fact of an agent asking a person *if* that person would accompany him does not mean that such a person then would be considered under arrest. This is true even though the agents may have come into the area with the intention of placing someone under arrest. It is what happened at and near the time of arrest which determines the issue, not what the agents had previously decided to do. Thus, they would still be entitled to consider the Mexican handbag and the statements of one or more of the women with respect to having just returned from Mexico as a final piece of corroboration to the truth of Martinez's story. In fact, Agent Spohr no doubt delayed placing appellant under arrest for the purpose of receiving some information from her.

It is clear that the officers were justified in believing that time was of the essence. The agents had no opportunity to procure a warrant of arrest. They did not finish questioning Martinez until after 6:00 in the evening, a time when judicial officers normally are no longer at their offices. Considerable delay would have been caused in attempting to find a judge or commissioner and then arranging for the warrant. Martinez told the officers that appellant was at the Greyhound Bus Depot in the city of San Diego and that they had been told to stay there where their husbands would join them for the trip to San Francisco. It is obvious from the transcript of evidence that the women could well have been at the bus depot from

even before 3:00 in the afternoon up to the time the officers concluded talking to Martinez. The arrangements had been made for the men to meet their wives at the bus station at approximately 5:30 and the officers did not arrive in San Diego until 6:45. Under all the circumstances, it was reasonable for the officers to believe that the women could have become impatient and apprehensive about their husband's failure to show up and proceed north without them. On the court's finding of the distances involved in even attempting to locate the United States Commissioner, to which no objection was placed by trial counsel at the hearing, the officers could probably not have reached the bus station until two or more hours after the time they did arrive. During that time the women were transitory and very likely would not have been there. Starting to travel to San Diego at a time *after* the two men were supposed to meet their wives in the latter city, the agents had to act fast.

Mr. Justice Minton, in *United States v. Rabinowitz*, 339 U. S. 56, stated, at page 65:

"A rule of thumb requiring that a search warrant always be procured whenever practical may be appealing from the vantage point of easy administration. We cannot agree that this requirement should be crystallized into a *sine qua non* to the reasonableness of a search. It is fallacious to judge events retrospectively and thus to determine, considering the time element alone, that there was time to procure a search warrant. Whether there was time may well be dependent upon considerations other than the ticking off of minutes or hours. The judgment of the officers as to when to close the trap on a criminal committing a crime in their presence or who they have reasonable cause to believe is committing a felony is not determined solely upon whether there was time to procure

a search warrant. Some flexibility will be accorded law officers engaged in daily battle with criminals for whose restraint no laws are essential.

“It is appropriate to note that the Constitution does not say that the right of the people to be secure in their persons should not be violated without a search warrant if it is practicable for the officers to procure one. The mandate of the Fourth Amendment is that the people shall be secure against *unreasonable* searches. It is not disputed that there may be reasonable searches, incident to an arrest, without a search warrant. Upon evidence of this established rule that some authority to search follows from lawfully taking the person into custody, it becomes apparent that such searches turn upon the reasonableness under all the circumstances and not upon the practicability of procuring a search warrant, for the warrant is not required. To the extent that *Troupiano v. United States*, 334 U. S. 699, requires a search warrant solely upon the basis of the practicability of procuring it rather than upon the reasonableness of the search after a lawful arrest, that case is overruled. *The relevant test is not whether it is reasonable to procure a search warrant, but whether the search was reasonable.*” (Emphasis added.)

The facts in *United States v. Walker*, 246 F. 2d 519 (7th Cir. 1957) are similar in some respects to those in the within case. In a narcotics prosecution the defendant made a motion to suppress under Rule 41 of Title 18. The trial court denied the motion on the ground that the agent involved had “reasonable ground” to believe that the defendant was committing a crime. The Court of Appeals affirmed the judgment. The defendant testified in support of his motion and it developed that he had never been previously arrested. On the day of the arrest he left his

home in the afternoon in his automobile accompanied by two adults and a child. While the defendant was proceeding along a public street, his automobile was curbed by another vehicle in which the federal agents were riding. The defendant and all occupants of his automobile were ordered out and told to place their hands on the top of the vehicle and submit to search. The defendant testified that at the time of the arrest, search and seizure he was not violating any laws, but was just driving down the street.

The only evidence in the agents testimony which was allowed in the record with respect to the source of his facts was that he had received information concerning the defendant and thereafter made a check of the files in his office for the name of the defendant, which check was negative. In the company of another agent he proceeded in his automobile to a certain place and observed a Pontiac that had been described to him over the telephone by the informant. The agent maintained surveillance on the Pontiac and eventually saw the defendant in the company of another man whom he had arrested three weeks prior to that time. The agent subsequently came up to the car and told the defendant he was under arrest. Thereafter, in searching him at that place the agent found a cigarette package on the defendant's person containing a glassine envelope with a white powder inside. During these times the agent had no knowledge of his own about the defendant, and only had the information which the informant had given him over the telephone. In an extensive review of the problems involved in determining probable cause, the court stated that "fresh combinations of facts must necessarily be examined under the terms labeled 'probable cause' and 'reasonable grounds' for neither one is a static concept." The court in that case held, in effect, that the officer was not acting only on an "inkling."

It is interesting to note that the *Walker* case, *supra*, is cited in appellant's opening brief at page 16, apparently with approval. Also it should be noted that the court said "that defendant was traveling by automobile further explains the need for action without a warrant."

With respect to *Contee v. United States*, 215 F. 2d 324, 326, cited in appellant's opening brief, the court in the *Walker* case, *supra*, stated "that Contee * * * is inapposite is patent from the flimsy testimony given by the arresting officers, in that appeal."

In the *Contee* case, the court stated:

"As we have seen, the officer here testified that an individual who 'lived in the neighborhood, apparently, and knew Contee' was his sole source of information. An *uncorroborated tip* by an informer whose identity and reliability are both unknown does not constitute probable cause to make an arrest. Nor is any exceptional circumstance alleged to have existed here; there is *no suggestion that appellant would have escaped*, or there was any necessity for apprehending him in the small hours of the morning." (Emphasis ours.)

The evidence there had shown that the officers only source of information was a man who told him that *Contee* "was the party that had been involved in some robberies." The agent stated that he didn't even know the informant's name. Further, the agent was unaware of whether the man actually lived in the defendant's neighborhood and really knew the defendant. *The informer was not one of the witnesses.*

It is evident that the facts of the case in *Contee v. United States*, *supra*, do not parallel in any respect the circumstances in the case under consideration here. The

arrest was made at the defendant's house at a time when there was no emergency shown to exist and it was made on uncorroborated and brief information supplied by an informant who was unknown even to the agent. Also, there was no showing in the case that the agent had had any chance at all to observe the demeanor of the anonymous informant.

In the case of *United States v. Castle*, 138 Fed. Supp. 436, cited in appellant's brief, the court complained that there was no emergency shown. It was stated that the agents could have put surveillance on the house of the defendant since they had heard of his alleged illegal activities before the particular time involved in the case. The defendant was still there at his home and there was no showing that he was planning to escape from the premises. Thus, that case is also distinguishable from the instant matter.

In view of all of the above reasons showing that officer Spohr and Officer Gates had probable cause in effecting the arrest of appellant, it is not considered necessary to extensively explore the question of whether or not the two parcels of heroin were given to the agent with consent of appellant. Again, appellant's opening brief is somewhat misleading in a statement relating to the transfer of the Kleenex tissue and heroin to the agent. At page 6, appellant states, "He immediately demanded that she give it to him, which she did" [Tr. 117]. However, agent Spohr testified that "I asked her what she had in her hand and *I would like to see it*" [Tr. 116]. (Emphasis ours.) Perhaps appellant was referring to the finding of fact by Judge Carter as follows: "He said, 'what have you got in your hand?' Mrs. Rodgers showed him the Kleenex and he said, 'give it to me'" [Clk. Tr. 49]. However, the agents testimony was actually as indicated above. After

Mrs. Rodgers had handed over the Kleenex containing the rubber contraceptive and white powder similar to heroin, agent Spohr then stated "where's the rest of it." Mrs. Rodgers then reached into her dress and produced another Kleenex which also held a rubber contraceptive containing a white powder like heroin. There was no threat or force used in recovering the heroin from Mrs. Rodgers nor was she touched in any way by the agents or anyone else in that respect. Thus, it might be said that the appellant consented to giving the heroin to Agent Spohr. However, it is felt that the question of whether or not the judgment of conviction should be affirmed should be based upon the fact that the officers did have probable cause in their actions.

In conclusion on this point, the Supreme Court in *United States v. Rabinowitz*, 339 U. S. 56, stated with respect to the test of reasonableness under all circumstances (p. 65): "Some flexibility will be accorded most officers engaged in daily battle with criminals for whose restraint criminal laws are essential." And also (p. 66), "The relevant test is not whether it is reasonable to secure a search warrant but whether the search was reasonable. That criterion in return depends upon the facts and circumstances—the total atmosphere of the case." Congress enacted Title 26, United States Code, Section 7607 in part to afford such flexibility to narcotic enforcement officers in view of the easy concealment, transportation and destruction of narcotics because of their small volume and high price. This problem is particularly acute at the border between Mexico and California. See House Public Committee Report on Narcotics, 2 United States Code Congressional and Administrative News, page 3302 (1956).

III.

**No Error Was Committed by the District Court in
Connection With Agent Spohr's Notes.**

Initially, it should be noted that the requests to see agent Spohr's notes were made during his testimony on certain *pre-trial* procedure.

On December 18, 1957, appellant and her deceased husband, Evan W. Rodgers, who was then a defendant in the same action, filed a notice of motion and motion to suppress the heroin which had been given to agent Spohr by appellant on October 11, 1957 [Clk. Tr. 3-12].

The above motion was filed pursuant to the provisions of Rule 41(e) of the Federal Rules of Criminal Procedure which provides that "the motion shall be made *before* trial or hearing * * *" (Emphasis ours), with certain exceptions noted therein.

There is no showing in the record that, at the time the motion was filed and during the hearing itself, appellant had an understanding with the government that the evidence adduced during the hearing on the motion would be deemed to be the trial of the case. As a matter of fact, after the hearing of the motion to suppress and the entry of not guilty pleas by each defendant [Tr. 217], the government asked to have an early setting for trial [Tr. 218] and stated that the case would probably only take two days to try [Tr. 219]. The court then set the case for trial on January 14, at 10:00 A.M. [Tr. 220, Clk. Tr. 24.]

Thereafter, the government and appellant on February 14, 1958 prepared a stipulation that the evidence introduced on hearing of the motion to suppress could be heard and considered by the court as evidence on trial of

the merits of the case, "having the same weight and sufficiency *as though introduced anew*." (Emphasis ours.)

The stipulation further provided that

"the defendant herein waives all objections to the introduction of said evidence except that defendant objects to the introduction of said evidence on grounds heretofore set forth by defendants in connection with their motion to suppress evidence."

It is apparent that by the provisions of the stipulation the appellant waived *all* objections to the introduction of the evidence, except that she was still contending that the heroin should be suppressed because of the alleged lack of probable cause. The fact that trial counsel for appellant was only depending on the possibility of the court reconsidering its denial of the motion to suppress on the above ground is particularly apparent when it is considered that he, and appellant, in effect, stipulated to the latter's guilt under the section, if the evidence were not suppressed, because it was provided therein that the powder contained in the two rubber contraceptives was brought into the United States from Mexico by appellant and that upon analysis the powder was found to be and was heroin.

Thus, it is clear that under the stipulation appellant intended to and did abandon any objection to the introduction that she was still hoping the court would reconsider its decision on the motion. If appellant had desired to preserve any of the specific rulings on her objections to evidence or motions which had been made during the time of the pre-trial hearing for reconsideration of the trial court on the issue of her guilt, she could have easily done so within the terms of the stipulation itself. After the hearing of the motion to suppress, and up to the time

the stipulation was actually prepared by the parties on February 14, 1958, and even up to the time it was approved and filed by the District Judge on March 10, 1958, there was ample opportunity for counsel for appellant to consider the incorporation of a provision for the preservation of his right to request the notes which were mentioned during the agents testimony, and, if such were granted, for further cross-examination of the agent.

It should be also noted at this point that, as will be discussed hereafter, counsel for appellant did not lay a sufficient foundation for the production of any such notes, except one, for his use at the time of the pre-trial hearing nor did he call the court's attention to any applicable law which would govern their production. This could have been done upon a renewal of his request for the notes pursuant to a provision of the stipulation preserving his right to do so.

The record shows that the motion to suppress was heard beginning December 23, 1957 at San Diego, California. As of that time, not only the case of *Jencks v. United States*, 353 U. S. 657, had been decided, but Section 3500 of Title 18, United States Code, providing for the production of certain statements, had been in effect since September 2, 1957.

In the case of *United States v. Palermo*, 258 F. 2d 397 (2nd Cir. 1958), the court held that

"This section was enacted after the decision of the United States Supreme Court in *Jencks v. United States*, 353 U. S. 657, 77 S. Ct. 1007, 1 L. Ed. 2nd 1103. Its purpose was to fix standards by which statements and reports of a witness in the possession of the government should be made available to a defendant in a criminal prosecution after the witness had testified. * * * Without considering whether

there is a conflict between the *Jencks* decision and the requirements of section 3500, we hold that the legislation is the *exclusive* standard in this field and controls the procedure to be followed in such cases. Otherwise, the legislation is meaningless.” (Emphasis ours.)

Section 3500 provides in part:

“(a) in any criminal prosecution brought by the United States, no statement or report in the possession of the United States which was made by a government witness or prospective government witness * * * to an agent of the government shall be the subject of subpoena, discovery, or inspection until said witness has testified on direct examination in the *trial* of the case.” (Emphasis ours.)

It should be noted also that the statute in sub-paragraph (c) provides for an

“in camera inspection of an alleged statement by the court in order that such portions of the statement could be excised which do not relate to the subject matter of the testimony of the witness.”

The statute in that sub-paragraph also refers to the “trial.”

It is obvious that the provisions of the so-called “Jencks Law” that is, Section 3500, are *only* applicable to testimony given during the *trial* itself, not to pre-trial procedure. Any other conclusion would fly in the face of the statute itself.

While it is true that the evidence adduced at the time of the motion to suppress, together with certain other agreements of fact contained in the stipulation filed in March, later were considered by the court on the merits of

the questions of appellant's guilt, at the time the motion to suppress was heard it was not considered to be more than a pre-trial hearing on the issue of probable cause. That is, the testimony taken during that motion was primarily geared to matters of *hearsay* from which the court was called upon to determine whether or not the officer had reasonable grounds to arrest the appellant. Thus, it became necessary for the appellant, in order to preserve any alleged right to view agent Spohr's notes, to do so within the terms of the stipulation which was filed at the later date.

In the case of *United States v. Palermo*, 21 Fed. 11 (U. S. D. C., N. Y. 1957) the District Court stated at page 13:

"It has been regarded as well settled that a defendant in a criminal case is not entitled to pre-trial inspection of the statements of prospective prosecution witnesses (citing cases)."

The above court went on to discuss the defendant's argument in the *Palermo* case that the *Jencks* case placed a different aspect on the

"hitherto well-settled rule denying defendants in criminal cases the right to inspect statements of prospective prosecution witnesses. He asserts that at least two of the witnesses from whom the government has taken statements—his own two accountants—who prepared the questioned income tax returns—will necessarily be called by the government at the trial in order to make out a case. Arguing from this premise, defendant contends that, since, under the *Jencks* case, he will be entitled to inspect the statements of such witnesses in the hands of the government when they are put on the stand he should

necessarily be allowed to have such inspection before trial under Rule 17(c), F. R. Crim. P.

“The defendant’s premise that these witnesses will necessarily be called by the government cannot be substantiated. * * * the Government * * * was not committed to calling either the two accountants or the two Special Agents.”

If a conventional trial had been had, with the calling of witnesses, Agent Spohr could not have testified as to the hearsay information he had secured from talking to Martinez, except as to the issue of probable cause, had that issue been reserved for the trial. Agent Spohr could only have testified as to what he saw or did and of his specific contact with and the arrest of the appellant, following which the heroin was secured. The notes of Agent Spohr probably concerned themselves with probable cause derived from information related to him by Martinez. There was no showing of a “statement,” as such, so far as the witness agent Spohr was concerned.

At any event, the government’s position is that, even so, the appellant is not entitled to the notes by reason of Section 3500 before actual trial is commenced. This is logical since it is normally only at the trial that the facts relating to the *issue of guilt* would be pertinent. It is felt that Section 3500, not only by its terms, but in reason applies to the time when witnesses are presented against the defendant on the direct question of whether or not a violation of law by that defendant has occurred.

In *United States v. Rosenberg*, 157 Fed. Supp. 654 (U. S. D. C. Pa. 1958) the court stated at page 661 “the decided cases make it clear that a defendant has no right *prior to the trial* to statements of witnesses * * * (citing cases)” (emphasis ours).

That court also quoted with approval from *United States v. Rosenberg* (3rd Cir. 1957), 245 F. 2d 870, at 871 as follows:

“‘The failure of the trial judge to permit counsel for the defendant to inspect *at the trial* the witness’ grand jury testimony and statement to the FBI, as required by the rule announced in the Jencks case, compels us to grant a new trial.’” (Emphasis applied.)

Thus, the District Court in the *Rosenberg* case at 157 Fed. Supp. 654 rejected the defendant’s contention that the court had the duty of submitting certain statements to the defendant prior to trial.

In the case of *United States v. Walker*, 246 F. 2d 519, *supra*, the court stated at page 525:

“The key issue at that suppression hearing was whether Spaline had reasonable grounds to believe that Walker had committed or was committing a violation of any law of the United States relating to narcotic drugs. Communication emanating from the informer was relevant to show that Spaline obtained knowledge about Walker forming the foundation on which the agent built his cause for acting. The informer’s testimony was *not* offered at the *pre-trial hearing* for the purpose of proving Walker guilty of the offenses for which he was about to be tried—the issue at that preliminary stage is related to Spaline’s state of mind. * * *” (Emphasis ours.)

The above *Walker* case emphasizes the fact that a suppression hearing is a “preliminary stage” and that the only issue thereon is related to the agent’s state of mind, not the defendant’s guilt of the offenses for which he is about to be tried. Because of the nature of the suppression

hearing and the issue involved, it is submitted, as indicated above, that the terms of Section 3500 should not be improperly extended to anything but the "trial" of the case where the issue of the defendant's guilt for the offenses is then at hand. *Otherwise, pre-trial could be used for improper discovery.*

Further, it should be stated that it can hardly be claimed that the defendant suffered any prejudice by reason of the court's denial of access to Agent Spohr's notes. There was no specific showing that there was anything in the notes which related to more than two small points of the agent's testimony on the issue of probable cause. As a matter of fact, the defendant was allowed to see the agent's notes on one of those matters, that is, Martinez's place of employment. The other involved a question of the amount of cash which the appellant's deceased husband, not appellant, had on his person at the time he was placed in custody at the border. The court then denied that latter request on the grounds that it was not a material point to the hearing.

Further, it appears that only one yellow sheet was marked as Exhibit No. 1 and ordered sealed by the court. Appellant up to this time has apparently not endeavored to secure an order of the District Court so that the sheet involved could be examined by this appellate court to determine whether any of the testimony other than as indicated in the record was material to the testimony. Although it is not clear, it seems from the record that there were other notes which were not sealed as Exhibit No. 1. Thus it does not appear that this court has before it an adequate record to consider any question of materiality or prejudice which may have resulted to appellant by reason of the court's ruling.

The first time the notes in question were mentioned was on cross-examination of agent Spohr by trial counsel for appellant. At that time [Tr. 140] agent Spohr had only one paper before him on which he apparently had written down the name of the nursery where Martinez stated he worked [Tr. 138, 140]. The rest of the notes were in the possession of government counsel. At counsel's invitation, witness Spohr used that note to refresh his recollection and gave the exact name of the nursery where Martinez told him he worked. Later, counsel for appellant asked the court if he could look at the paper that witness Spohr had used to refresh his recollection, that is, the one on which the address and occupation of Martinez was noted. The court then showed counsel that part of the note which contained the name and address of Martinez's place of employment. That was apparently the only note which was marked for identification as Exhibit 1 [Tr. 165-166].

Previously, counsel for appellant asked witness Spohr some questions which respect to some small cash which Mr. Rodgers had had in his possession, in addition to the \$2,000.00 check, at the time he was taken into custody on October 11, 1957. Counsel asked Spohr if the former would like to check his notes to determine how much cash Rodgers had had. The witness answered

“‘I don't recall how much it was (stepping down from the witness stand).’ Then counsel for appellant stated ‘It must be a valuable file. Will you take your notes back to the witness stand, please, Mr. Spohr?’

“Your Honor, *I think* the witness refreshed his recollection from something at the table. I would like to look at it if I may.”

Witness Spohr stated that all he did was to put the amount of money at the top of the heading. The court then denied counsel's request to look at the note [Tr. 164, 165]. There was no foundation laid to show that witness Spohr actually did refresh his recollection from it. Counsel for appellant only stated that he *thought* that the witness had refreshed his recollection. Thus, from the record it is impossible for this court to determine whether or not the witness had actually refreshed his recollection on that point.

The above appeared to be the only two instances where any mention is made that the witness Spohr refreshed his memory from notes. In connection with Martinez's occupation, counsel for appellant was shown the note to that effect. On the other, with respect to the cash, an insufficient foundation was laid to show that the witness actually refreshed his recollection from any notes.

Thereafter counsel for appellant, after looking at the notes containing Martinez's place of employment, asked the court "Are you just going to show me that portion of it?" The court then replied, "Yes, that is what you wanted to see, the notes that showed the address and Martinez's place of employment." Then counsel for appellant stated that he "would like to see them all * * *." Technically, it could be said that the court did not actually deny defendant's request, as all he stated was "I wouldn't be surprised you would." Counsel did not pursue his request further or ask the court if his request had been denied, only saying, "Could it be marked, Your Honor?" The court then allowed the one note that showed Martinez's place of employment marked Exhibit No. 1 for identification as requested and thereafter sealed it.

It may be of interest to this court to note that witness Spohr stated that whether or not Martinez had told him of any prior arrest was not set forth in his notes [Tr. 141]. Also agent Spohr did not put in his notes the information that Martinez gave him as to how long Martinez had been using narcotics [Tr. 144-145]. The "first" conversation, which counsel for appellant asked Agent Spohr about was not in the notes (apparently Agent Spohr was referring to a "fishing expedition" which he had with Martinez prior to the time Martinez told him of the trips to Tijuana for heroin) [Tr. 145].

From the above, it is apparent that the only foundation laid as to the contents of the notes was in respect to the small amount of cash which Rodgers had on his person at the time he was taken into custody, a fact held not material to the hearing by the court, and Martinez's place of employment. The only specific testimony was to matters *not* contained in the notes.

Under the case of *United States v. Miller*, 248 F. 2d 163 (2nd Cir. 1957), the court stated at page 166:

"Under the Jencks case the defense must lay a preliminary foundation that a statement or report is in existence and relates to the subject matter of the testimony of the witness. We do not think such preliminary foundation was laid with respect to a prior report by Shershen."

In the within case, it appears that it would be impossible to determine the relation of the notes to witness Spohr's testimony, because of the lack of proper foundation and the status of the record on appeal.

In conclusion on this second and final point, it is submitted that, however, the matter involving the notes should be disposed of upon the ground that appellant

during the pre-trial hearing had no right to see the agent's notes under the terms of Section 3500 of Title 18, United States Code, and, at any event, because of the stipulation which was later filed with respect to the actual trial of the case, abandoned any such request for production.

Conclusion.

In view of the above, the government strongly urges that the judgment of conviction the trial court, sitting without a jury, should be affirmed.

On the question of probable cause, as stated by the court in *Larson v. United States*, 254 F. 2d 706 (8th Cir. 1958), the *attending circumstances tended to corroborate* the statement by informant Martinez to Agent Spohr. The facts and circumstances known by the agent and the inferences that might reasonably be drawn therefrom were such as not only "to warrant but to *impel* a reasonably discreet and prudent man * * *" to believe that an offense had been committed by appellant. (Emphasis ours.) Thus, the defendant's rights were not violated under the Fourth Amendment because the "seizure" of the heroin was not unreasonable.

With respect to the notes, (1) the appellant was not entitled to access to any more of the notes than were shown to counsel at the time of the hearing on the motion to suppress. Although some of the evidence taken at the hearing, together with other stipulations as to facts, actually became the evidence upon which the government relied on the issue of guilt at a later time, it was not contemplated that such would be the case at the time the hearing proceeded, when he had no right to access. (2) Thereafter counsel failed to preserve his request and

actually abandoned the point for the purposes of trial. (3) On the only point on which Agent Spohr was actually shown to have refreshed his memory from a note, that portion of the notes was shown to counsel for appellant. Thus, no error was committed by the trial court in respect to this contention.

Respectively submitted,

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No. 16020

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

E. NADINE RODGERS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

I.

Introduction.

This brief is filed in reply to the brief of the appellee, United States of America, filed herein which seeks to sustain the conviction of appellant E. Nadine Rodgers on a charge of illegal importation of narcotics in violation of Title 21, U. S. C. A., Section 174, as amended July 18, 1956.

As stated at page 13 of appellant's opening brief, appellant admits that she did import heroin into this country from Mexico. Faced with the existence of such an act, the court is confronted with a powerful temptation to justify the conviction on any plausible ground. This is a hard case on the facts, and hard cases tend to make bad law. Appellant is confident that this Honorable Court will, despite the many frivolous legal callisthenics indulged

in by the government, cut through such obfuscations and dispassionately decide the case on the four major issues framed by the appellant's opening brief. These issues are basically: (1) the unlawful violation of appellant's rights under the Fourth Amendment by the action of Agents Gates and Spohr in arresting her without a warrant and without probable cause (App. Op. Br. pp. 13-42); (2) the correctness of three of the findings of fact (App. Op. Br. pp. 42-48); (3) the correctness of seven of the conclusions of law (App. Op. Br. pp. 49-59); (4) the error committed by the trial court in refusing to permit defense counsel to inspect a report prepared by and used by a government agent-witness in testifying (App. Op. Br. pp. 49-64).

II.

Appellant's Arrest and Subsequent Search Were Made in Violation of Her Rights Under the Fourth Amendment to the Constitution.

The circumstances leading to appellant's arrest are set out in appellant's opening brief at pages 2-6 and 18-20 and in the government's brief at pages 2-5. While no good purpose would be served by restating *ex extensio* the facts upon which the agents acted, the following is a brief summary of the information in their possession at the time of appellant's arrest:

(1) There was a suitcase containing woman's clothing in Evan Rodger's car.

(2) Evan Rodgers had a \$2,000 cashier's check on his person.

(3) Gilbert Martinez stated that appellant had carried heroin across the border and was waiting for her husband in San Diego.

(4) Appellant was in San Diego near the place where Martinez had said she would be.

(5) Appellant admitted her identity to Agent Spohr.

Other information in the possession of the agents related to the question of Martinez's reliability and was not directed to the probability of appellant's guilt or lack of it. Great stress is apparently placed by the government upon the circumstances that woman's clothing was contained in Evan Rodgers' car and that Evan Rodgers carried a \$2,000 check on his person when apprehended. Yet it is not unreasonable for a woman travelling far from home with her husband to leave some of her luggage in the car when her husband is going to take the car for a 150-mile trip. In any event, not only can no guilty inference be attached to the presence of the clothes, but they are nowhere identified as belonging to appellant. Appellant urges that the mere presence of unidentified woman's clothes in Rodgers' car can reflect upon appellant's probable guilt or upon the validity of Martinez's story only by the broadest exercise of supposition, conjecture, and surmise on the part of the arresting officers. The existence in the minds of the agents of probable cause to arrest appellant is not supported by the presence of the clothes in the car. Nor was the possession by Evan Rodgers of a \$2,000 cashier's check of any corroborative significance. Rodgers told the agents that this check represented part of the proceeds of a real estate transaction. The government, at pages 18 and 19 of its brief, attempts to create *nunc pro tunc* in the minds of the agents the thought that a \$2,000 cashier's check in the possession of a person with a prior narcotics record might well be indicative of the fact that the person had

just been involved in a narcotics transaction. Appellant submits that this Honorable Court can take judicial notice of the fact that narcotics purchases are seldom made by cashier's check. Accordingly, no significance is attributable to Evan Rodgers' possession of the check.

Additionally, it should be noted that both of the aforementioned bits of alleged corroboration were unearthed in the possession of one other than appellant and lend no support one way or the other to the probable cause the agents may have had to arrest her. Without the check and the clothes, neither of which should be considered corroborative, the sole facts upon which the agents founded their decision to arrest appellant were that a man previously unknown to them personally or by reputation and, as far as they could ascertain, of extremely dubious character told them that a woman whose very existence was unknown to them had carried heroin into the United States and was at that time in San Diego. This is a classic example of an arrest by officers in reliance upon information supplied by an informant of unknown reliability. Under the established authorities, an arrest founded upon such flimsy grounds is unlawful as being in violation of the arrested person's constitutional rights under the Fourth Amendment.

The government in stressing the opportunity of the agents to observe Martinez firsthand throughout a protracted interrogation confuses the basis of the rule against arrests based upon information supplied by informants of unknown reliability. It is not the identity of the informant which must be known, nor is it the opinion or impression which the agents gain of him during their

interrogation; it is the proven reliability of the informant which is of prime importance. As so aptly stated in

United States v. Clark (1939), 29 Fed. Supp. 138 at 140,

there must be some showing "that the informer's information was itself more than mere guess-work and speculation." Needless to say, the information must be vindicated, if at all, prior to the arrest made in reliance upon it and not by reason of the fruits of the arrest and the resulting search.

United States v. Di Re (1948), 332 U. S. 581, 92 L. Ed. 210, 220.

Of interest to show that, contrary to the tenor of appellee's argument, the opportunity of arresting officers to observe an informer's demeanor face to face does not vary the rule that reliability of the informant, rather than his identity, must be known is the case of

People v. Goodo (1956), 147 Cal. App. 2d 7, 304 P. 2d 776.

In that case, as in the instant case, the police were personally contacted by an informant previously unknown to them either personally or by reputation. This informant informed the officers that Goodo kept marihuana in his room. The police had an opportunity to speak to and observe this informant for nearly an hour and in his company went to Goodo's apartment where they intercepted Goodo as he came out of the door of his room with a brown paper sack in his hand. Goodo was arrested; the sack contained contraband; and Goodo was convicted. Upon appeal the conviction was reversed, the

court stating at page 9 of the California Appellate Report:

“The question here presented is whether the information given by Bruce to the officers, coupled with their observation of appellant leaving his living quarters with a brown paper sack in his hand, was sufficient to constitute reasonable cause to believe that appellant was guilty of a felony.

“It appears that the officers had not previously known Bruce or had any contact with him and that they did not know his reputation or any other fact which would assist in evaluating his reliability. In the absence of any emergency, ‘an arrest may not be based solely on such information.’”

See also:

Willson v. Superior Court (1956), 46 Cal. 2d 291, 294 P. 2d 36.

In the instant case, the mere fact that the agents had Martinez before them, observed his demeanor, and established his identity in no way affects their knowledge of his reliability. As it turned out Martinez’s information was correct and he might, consequently, *at the present time* be considered “reliable” in a legal sense, but the fact remains that at the time the agents acted they were utterly in the dark as to whether or not Martinez was a reliable informant.

The government seeks to substitute for the standard of known reliability the evaluation of the informant’s demeanor gained by the officers during interview and, on this ground, seeks to distinguish appellant’s cases where the informant was anonymous. It is, perhaps, significant that no citation of authority is given in support of this somewhat startling concept which would apply to police

officers the same aura of sacrosanctity which is presently accorded trial judges in their evaluation of the demeanor of witnesses. Such a rule, if followed, would substitute the officers' *opinion* as to the reliability of the informant in place of definite knowledge of said informant's reliability. The dangers of such a policy are immediately apparent since the Fourth Amendment interdictions would possess no more protection than the character evaluating ability of each individual arresting officer. Caprice, whimsy, and even deliberate falsification would replace the present necessity for showing definite knowledge of an informant's prior reliability. In a government of laws—not men—such a circumstance cannot be tolerated.

In the instant case, the officers had no concrete reason to suspect that Martinez's story was other than mere guess-work. Various factors which the government seeks to use in buttressing the unfounded suspicions of the agents are either equally susceptible to contrary interpretation or are completely unfounded in the record. Thus on page 10 of the government's brief, the appellee has indulged in speculation, stating:

"It is obvious from the transcript that Martinez and Rodgers did not have a chance to get together on their stories while being interrogated by the Customs agents."

The record is silent on this aspect of the case, the sole utterance to this effect being the unsupported allegation of government's counsel just quoted.

On pages 12 and 13 of the appellee's brief, the government represents that Agent Spohr checked local police records and discovered only a minor violation of the law by Martinez. There is no support whatsoever in the

record for this statement. At page 13 of its brief, the government engages in "inference" to arrive at the conclusion that Evan Rodgers' prior arrest was verified by the State Narcotics Bureau. Whether Officer Bud Hawkins of the State Narcotics Bureau did or did not state that Evan Rodgers had a prior narcotics record remains unknown from a reading of the record. The correct statement of the testimony on that subject is set forth at page 12 of appellant's opening brief. The government again resorts to inference on this point; the appellant relies upon the record.

Again at page 19 of its brief the government seeks corroboration in Martinez's mouthings of the names of members of the Federal Bureau of Narcotics in San Francisco. This information could be material only if considered by the agents in establishing Martinez's reliability inasmuch as he claimed to have known these men through alleged work as an informer. It is submitted that such a conclusion is not compelled by Martinez's mere mention of these names nor, in view of Martinez's admitted familiarity with the narcotics racket from the wrong side of the law, is it justified in that it is at least equally probable that Martinez knew of these men in the same way any narcotics addict might know the names of the small group of agents who seek to enforce the narcotics laws. In any event, as pointed out at pages 39-41 of appellant's opening brief, probable cause to arrest without a warrant cannot be predicated upon information provided by an informant whose *reliability* is unknown to the arresting agent personally even though the reliability of the informer is vouched for by another party of known reliability.

If Martinez's reliability could not be validly authenticated for the arresting agents' purposes by confirmation by one of the named San Francisco narcotics agents, how then can it be successfully contended that, when the situation is one step further removed, Martinez can authenticate his own reliability by merely mentioning the names of some of those agents? At page 20 of the government's brief, appellee attempts to corroborate Martinez's story by the allegedly suspicious actions of one other than appellant. It is there argued that Evan Rodgers' failure to reveal his wife's presence in San Diego somehow directed suspicion against her. To so hold would be to establish a dangerous precedent in that overzealous officers would then be at liberty to "roust" any designated person merely because of the suspicious actions of a party other than the one arrested.

It is interesting to observe the unique manner in which the government seeks to establish Martinez's reliability. Unlike the usual practice which aims to show the informant as a pillar of the community, possessing sterling moral character, and thus meriting credence, appellee herein urges that because Martinez was a heroin addict (Gov. Br. pp. 10, 14), that because he had just violated Title 18, U. S. C. A., Section 1407 (Gov. Br. p. 14), that because he was awaiting trial on a narcotics offense (Gov. Br. p. 10), and that because the information was extracted from him by coercive interrogation combined with promise of benefit (Gov. Br. p. 11) he is somehow very worthy of belief and the agents should have immediately considered him reliable.

Appellant submits that these very considerations mitigate against any reasonable decision by the officers that Martinez was reliable and his information, in and of it-

self, justified an arrest without a warrant. The arrest was unreasonable; appellant's constitutional rights were infringed; and the judgment of conviction must, accordingly, be reversed.

III.

Certain of the Findings of Fact and Conclusions of Law Were Erroneous.

The invalidity of certain of the findings of fact and conclusions of law was treated at length at pages 42-59 of appellant's opening brief. Appellant does not wish to belabor the points and here confines herself to a brief discussion of two points which were erroneously treated in the government's brief.

(a) The Court Did Not Take Judicial Notice That a Delay of Several Hours Would Be Necessitated to Get a Warrant for Appellant's Arrest.

At page 4 of its brief, the government makes the statement that—

“The Court took judicial notice that if a judge or commissioner were found at home the distance and traffic would cause several hours delay if a Warrant were sought.”

The sole reference in the record relating to the time involved in obtaining a warrant is contained at page 151 of the transcript wherein it is stated by the court:

“* * * Let the record show, first, that the Commissioner lives in Point Loma, and that probably at best, if available at the home, it would be thirty minutes or more before she could be reached.”

Despite this clear and simple statement by the court, the government, both in the findings and in its brief, has

persisted in distorting the one-half hour mentioned by the trial court into "several hours." While this point is of small consequence, appellant feels it necessary to correct the discrepancy between the government's allegations and the facts.

(b) The Conclusion of Law That No Search Was Made of Appellant to Secure the Narcotics From Her Is Not Borne Out by the Record.

At pages 27 and 28 of the government's brief the fallacious argument is made that there actually was no search of appellant at all, but rather she voluntarily disclosed to Agent Spohr the heroin which she carried. Appellant extensively treats this question at pages 56 through 59 of her opening brief. At the time that appellant is alleged to have voluntarily disclosed the possession of heroin to Agent Spohr she was in the custody of the federal authorities in San Diego Jail, being marched down a corridor thereof to a detention room where a matron waited to search her. The government disagrees that Agent Spohr demanded to see what appellant held in her hand and by an adroit use of semantics attempts to show the voluntary nature of the disclosure. Agent Spohr testified that he had said to appellant that he would *like* to see what was in her hand. In the context of the circumstances extant at the time, appellant submits it makes little difference whether Agent Spohr said he would *like* to see the narcotics or that he *wanted* to see the narcotics, or that he *insisted* upon seeing the narcotics. The end result is the same. Appellant was in custody and was painfully aware of the fact that she would be searched within the next few minutes. It does not require the overpowering use of physical force to constitute a search. Appellant's rights under the Fourth Amendment against unreasonable search are not to be waived by a mere play on words.

IV.

The Trial Court Erred Under Title 18, U. S. C. A.,
Section 3500 in Not Permitting Defense Counsel
to Inspect the Notes From Which Agent Spohr
Testified.

Appellant in Point V of her opening brief took the position that in view of the rule laid down in

Jencks v. United States (1957), 353 U. S. 657,
77 S. Ct. 1007, 1 L. Ed. 2d 1103,

the action of the trial court in refusing permission to defense counsel to examine a report from which Agent Spohr testified was error. The government in Point III of its brief takes exception to the applicability of the *Jencks* case and insists that the rule in that case has been superseded by Title 18, U. S. C. A., Section 3500, the so-called "Jencks Statute."

Assuming *arguendo* the correctness of the government's position and further assuming, but not conceding, that

United States v. Palermo (2d Cir., 1958), 258
F. 2d 397,

limits a defendant to the protection of Section 3500, it is appellant's contention that, even under the *Jencks* Statute, the trial court erred in not permitting the inspection of the questioned report by defense counsel. Section 3500, *supra*, provides in pertinent portion:

"§3500. Demands for production of statements and reports of witnesses

"(a) In any criminal prosecution brought by the United States, no statement or report in the possession of the United States which was made by a Government witness or prospective Government witness (other than the defendant) to an agent of the Government shall be the subject of subpoena, discov-

ery, or inspection until said witness has testified on direct examination in the trial of the case.

“(b) After a witness called by the United States has testified on direct examination, the court shall, on motion of the defendant, order the United States to produce any statement (as hereinafter defined) of the witness in the possession of the United States which relates to the subject matter as to which the witness has testified. If the entire contents of any such statement relate to the subject matter of the testimony of the witness, the court shall order it to be delivered directly to the defendant for his examination and use.

“(c) If the United States claims that any statement ordered to be produced under this section contains matter which does not relate to the subject matter of the testimony of the witness, the court shall order the United States to deliver such statement for the inspection of the court in camera. Upon such delivery the court shall excise the portions of such statement which do not relate to the subject matter of the testimony of the witness. With such material excised, the court shall then direct delivery of such statement to the defendant for his use. * * *”

It should in passing be noted from the above quoted material that contrary to the impression gained at page 32 of the government's brief in camera inspection of statements is authorized under Subsection (c), *supra*, only where the government claims that the statement to be inspected contains matter which does not relate to the testimony of the witness. In the instant case no such objection was made by the government; *ergo*, any such in camera inspection was made by the trial court in excess of its authority under this act.

Appellant meets the requirements of Section 3500, *supra*. This was a criminal prosecution brought by the United States. The report was made, not only by a government witness to a government agent, but it was made by a government witness who was himself a government agent. The witness-agent testified in what was stipulated to be the trial of the case. After the witness-agent testified, defendant requested the court to allow defendant the right to inspect the report. The report related to the subject matter to which the witness testified (in fact the witness-agent on at least five occasions had to refer to the report during his testimony [Tr. 138-141, 145, 164, 165]). It is perhaps speculation to suppose that the entire contents of the report related to the testimony, but, as heretofore stated, since the government made no claim that the report contained matter which did not touch on the testimony of the witness-agent, the court had no right to inspect the report in camera and then restrict defendant's examination thereof to one line.

The government contends that not only does the Jencks Statute lack applicability because the testimony of the agent was offered at a hearing under Rule 41(e), Federal Rules of Criminal Procedure, Title 18, U. S. C. A., but also that appellant stipulated to her guilt if her arrest were upheld as legal. The answers to these two arguments are correlative. The stipulation contained at page 56 of the clerk's transcript provides that the proceedings in the Rule 41(e) motion could be considered in lieu of a trial and that appellant waived all objections to the introduction of all evidence except such objections as were raised by appellant on the motion to suppress evidence. The government takes the position that under this stipulation appellant merely wished to have the court reconsider its decision on the Rule 41(e) motion. Such a construc-

tion is not borne out by the record. A separate motion to reconsider was made by the appellant and is contained at page 26, *et seq.*, of the clerk's transcript. Appellant did not waive her right to raise the instant ground since the waiver in the stipulation extended only to the introduction of evidence.

The failure and refusal of the court to allow defense inspection of the report from which Agent Spohr repeatedly testified does not, under any stretch of a fertile imagination, become an objection to the introduction of evidence. Rather, it is a fatal flaw or defect in the conduct of the case by the trial court and, if touched at all in the stipulation, would come under the purview of paragraph three thereof in which appellant reserved all arguments of counsel, documents, and pleadings filed in connection with the motion to suppress. By the stipulation the government and the appellant stipulated that the hearing under Rule 41(e) would substitute for the trial, since to hold a trial would mean a mere reiteration of the Rule 41(e) hearing. Had the government wished to escape the impact of the trial court's violation of the *Jencks* rule, it should have so provided in the stipulation. It did not. Nor can the government successfully contend that defendant did not lay a proper foundation for a demand to inspect Agent Spohr's report. It is clear from the record that the report was presented in court, in fact, Agent Spohr repeatedly referred to it during his cross-examination [Tr. 138-141, 145, 164, 165]. The only foundation which must be laid is such as will show that there is a report in existence and that it relates to the subject matter to which the witness has testified. These requirements were clearly complied with, and the court erred in refusing to allow defense inspection of the report.

Conclusion.

In the premises, appellant urges that her arrest was made without a warrant and without probable cause and her conviction must be reversed. Further, the court should have granted defense counsel the right to inspect Agent Spohr's report. Contentions of the government that the court did not actually deny defendant's request to inspect the notes are mere cavil (Govt. Br. p. 38). Appellant regrets that the government at this and other points in its brief deems it proper to resort to frivolous legal semantic games on an issue as vital as a citizen's constitutional rights and her right to due process of law.

Respectfully submitted,

HARRY D. STEWARD,

THOMAS H. LUDLOW, JR.,

Attorneys for Appellant.

No. 16,021 ✓

IN THE

**United States Court of Appeals
For the Ninth Circuit**

UNITED STATES OF AMERICA,	}
vs.	
CHARLES BASSIL CLEMENTS, JR.,	
	<i>Appellee,</i>
	<i>Appellant.</i>

BRIEF FOR APPELLEE.

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PAUL P. O'BRIEN, CLERK



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No. 16,021

IN THE
United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellee,

vs.

CHARLES BASSIL CLEMENTS, JR.,

Appellant.

BRIEF FOR APPELLEE.

JURISDICTION.

This is an appeal from an order denying a motion to vacate sentence under 28 U.S.C. § 2255. Jurisdiction is based upon 18 U.S.C. §3231 and 28 U.S.C. §§ 1291, 1294 and 2255.

STATEMENT OF THE CASE.

The appellant is confined at the United States Penitentiary at Leavenworth, Kansas, having pleaded guilty to two violations of 18 U.S.C. §2421 (Mann Act). The eight-count indictment was returned and filed on March 20, 1957. The defendant pleaded guilty before Judge Murphy on April 24, 1957, to counts 1 and 2. Count 1 charged the commission of an offense

on March 23, 1952; count 2 charged the commission of an offense on March 27, 1952. Thus, the indictment was returned and filed just a few days before the five year statute of limitations, 18 U.S.C. §3282, would have run as to the two offenses here involved. The remaining six counts of the indictment charged offenses occurring somewhat later.

Also on April 24, 1957, the defendant was sentenced to serve five years on each of the two counts, the sentences to run concurrently. On March 31, 1958, the defendant filed a motion under 28 U.S.C. §2255 to vacate his sentence, noticing the motion for hearing on April 21, 1958. In his moving papers the defendant claimed that the prior three year statute of limitations applied and that, if the extended five year statute of limitations applied, the extension was an ex post facto law.

On April 1, 1958, without a hearing, Judge Murphy denied the motion to vacate. This appeal is from the order denying the motion.

SUMMARY OF ARGUMENT.

The extension of the statute of limitations from three years to five years applies not only to offenses committed on and after the date of enactment of the extension but also to offenses committed prior to that date if prosecution was not then barred. Therefore, the five year statute applies here and prosecution is timely. The ex post facto clause does not prevent application of the extension because prosecution was

not barred at the time of the extension. The denial of appellant's motion without a hearing was proper because the motion raised only questions of law which could be determined from the motion and the record.

ARGUMENT.

1. THE FIVE YEAR STATUTE OF LIMITATIONS APPLIES.

The extension of the statute of limitations became effective on September 1, 1954. At that time the three year statute had not run as to this prosecution. The amendment, 68 Stat. 1145, states that the extended period applies to offenses committed before enactment if prosecution was not then barred. Accordingly, the increased period of limitations is clearly applicable here. *United States v. Kurzenknabe*, 136 F. Supp. 17 (D.N.J. 1955). Appellant now seems to concede as much. Whereas, in his moving papers, he urged that the five year statute of limitations did not apply, he does not make any such contention in his brief.

2. THE EXTENSION OF THE STATUTE OF LIMITATIONS AS TO A PROSECUTION NOT YET BARRED IS NOT AN EX POST FACTO LAW.

It is clear that the ex post facto clause does not prevent extension of the period of prosecution, if, as here, the prosecution has not been barred at the time of the extension. *Falter v. United States*, 23 F.2d 420, 425-26 (2d Cir. 1928), and *United States v. Kurzenknabe*, supra.

The defendant's authorities involve attempts to revive prosecutions already barred. Interestingly, in *State v. Moore*, 42 N.J. Law 208 (1880), a case cited by the appellant (appellant's brief, p. 9), a statute reviving an already barred prosecution was held *not* to be an ex post facto law.

3. THE DEFENDANT WAS NOT ENTITLED TO A HEARING.

Since "the motion and the files and records of the case conclusively show [ed] that the prisoner [was] entitled to no relief (28 U.S.C. §2255)," a hearing was unnecessary. Section 2255 itself provides, "A court may entertain and determine such motion without requiring the production of the prisoner at the hearing." Indeed, it would have been a waste of public money and against public policy to have ordered a hearing and to have ordered the prisoner produced.

The cases cited by the defendant, *Waley v. Johnston*, 316 U.S. 101 (1942), and *United States v. Hayman*, 342 U.S. 205 (1952), involved issues of fact which could not be determined from the record. Therefore, those cases are not of use to the defendant. Indeed, in *United States v. Hayman*, *supra*, the Court indicated that prisoners should be produced for Section 2255 hearings only when necessary (pp. 222-223):

"The existence of power to produce the prisoner does not, of course, mean that he should be automatically produced in every Section 2255 proceeding. This is in accord with procedure in habeas corpus actions. Unlike the criminal trial

where the guilt of the defendant is in issue and his presence is required by the Sixth Amendment, a proceeding under Section 2255 is an independent and collateral inquiry into the validity of the conviction. Whether the prisoner should be produced depends upon the issues raised by the particular case. Where, as here, there are substantial issues of fact as to events in which the prisoner participated, the trial court should require his production for a hearing."

CONCLUSION.

The prosecution was timely. The motion was denied properly. It is respectfully submitted that the denial of the motion to vacate should be affirmed.

Dated, San Francisco, California,
August 5, 1958.

LLOYD H. BURKE,
United States Attorney,

BERNARD PETRIE,
Assistant United States Attorney,

Attorneys for Appellee.

(Appendix Follows.)



Appendix.



Appendix

INDICTMENT.

First Count: (Title 18, United States Code, Section 2421)

The Grand Jury charges that:

Charles Bassil Clements, Jr., hereinafter called said defendant, did on or about the 23rd day of March, 1952, in the City and County of San Francisco, State and Northern District of California, knowingly transport in interstate commerce, to-wit, from San Francisco, California, to Reno, Nevada, Betty La Verne Clements, a woman, for the purpose of prostitution.

Second Count: (Title 18, United States Code, Section 2421)

The Grand Jury further charges:

That on or about the 27th day of March, 1952, said defendant did, in the City and County of San Francisco, State and Northern District of California, knowingly transport in interstate commerce, to-wit, from Reno, Nevada, to San Francisco, California, Betty La Verne Clements, a woman, for the purpose of prostitution.

* * *

A True Bill.

/s/ W. J. Kohnke,
Foreman.

STATUTES INVOLVED.

18 U.S.C. §3282:

Except as otherwise expressly provided by law, no person shall be prosecuted, tried, or punished for any offense, not capital, unless the indictment is found or the information is instituted within five years next after such offense shall have been committed. As amended Sept. 1, 1954, c. 1214, §10 (a), 68 Stat. 1145.

68 Stat. 1145:

Sec. 10. (a) 3282 of title 18 of the United States Code is amended by striking out "three" and inserting in lieu thereof "five".

(b) The amendment made by subsection (a) shall be effective with respect to offenses (1) committed on or after the date of enactment of this Act, or (2) committed prior to such date, if on such date prosecution therefor is not barred by provisions of law in effect prior to such date.

Approved September 1, 1954.

28 U.S.C. §2255:

A prisoner in custody under sentence of a court established by Act of Congress claiming the right to be released upon the ground that the sentence was imposed in violation of the Constitution or laws of the United States, or that the court was without jurisdiction to impose such sentence, or that the sentence was in excess of the maximum authorized by law, or is otherwise subject to collateral attack, may move the court which imposed the sentence to vacate, set aside or correct the sentence.

A motion for such relief may be made at any time.

Unless the motion and the files and records of the case conclusively show that the prisoner is entitled to no relief, the court shall cause notice thereof to be served upon the United States attorney, grant a prompt hearing thereon, determine the issues and make findings of fact and conclusions of law with respect thereto. If the court finds that the judgment was rendered without jurisdiction, or that the sentence imposed was not authorized by law or otherwise open to collateral attack, or that there has been such a denial or infringement of the constitutional rights of the prisoner as to render the judgment vulnerable to collateral attack, the court shall vacate and set the judgment aside and shall discharge the prisoner or resentence him or grant a new trial or correct the sentence as may appear appropriate.

A court may entertain and determine such motion without requiring the production of the prisoner at the hearing.

The sentencing court shall not be required to entertain a second or successive motion for similar relief on behalf of the same prisoner.

An appeal may be taken to the court of appeals from the order entered on the motion as from a final judgment on application for a writ of habeas corpus.

An application for a writ of habeas corpus in behalf of a prisoner who is authorized to apply for relief by motion pursuant to this section, shall not be entertained if it appears that the applicant has failed to

apply for relief, by motion, to the court which sentenced him, or that such court has denied him relief unless it also appears that the remedy by motion is inadequate or ineffective to test the legality of his detention. June 25, 1948, c. 646, 62 Stat. 967, amended May 24, 1949, c. 139, §114, 63 Stat. 105.

No. 16022 ✓

United States
Court of Appeals
for the Ninth Circuit

LOS ANGELES MEAT AND PROVISION
DRIVERS UNION LOCAL No. 626 OF
THE INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFEURS, WARE-
HOUSEMEN AND HELPERS OF AMER-
ICA, et al., Appellants,

vs.

LEWIS FOOD COMPANY, a corporation,
Appellee.

Transcript of Record

Appeal from the United States District Court for the
Southern District of California,
Central Division

FILED

NOV 21 1958

PAUL P. O'BRIEN, CLERK



No. 16022

United States
Court of Appeals
for the Ninth Circuit

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DRIVERS UNION LOCAL No. 626 OF
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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HILL, FARRER & BURRILL,
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In the United States District Court, Southern
District of California, Central Division

No. 20333-BH

LEWIS FOOD COMPANY, a California corpo-
ration, Plaintiff,

vs.

LOS ANGELES MEAT AND PROVISION
DRIVERS UNION LOCAL NO. 626 OF
THE INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFEURS, WARE-
HOUSEMEN AND HELPERS OF AMER-
ICA, an unincorporated association; TEAM-
STERS, CHAUFFEURS, WAREHOUSE-
MEN AND HELPERS OF AMERICA LO-
CAL 542, an unincorporated association; DOE
ONE ASSOCIATION to DOE FIVE ASSO-
CIATION (inclusive of all intervening num-
bers as though each association was severally
and separately designated), each an unincorpo-
rated association; DOE ONE CORPORA-
TION to DOE FIVE CORPORATION (in-
clusive of all intervening numbers as though
each corporation was severally and separately
designated), Defendants.

COMPLAINT FOR DAMAGES

Comes now the plaintiff and for cause of action
against the defendants, and each of them, alleges:

I.

This action arises under the laws of the United

States regulating commerce; jurisdiction is conferred by virtue of Title 29 USC Section 187.

II.

Plaintiff is now, and at all times herein mentioned has been, a corporation organized and existing under the laws of the State of California. Plaintiff is now, and at all times herein mentioned has been, engaged in the business of manufacturing, producing, distributing and selling pet foods, with its principal place of business at 817 East Eighteenth Street, in the City of Los Angeles. County of Los Angeles, State of California.

Plaintiff at all times herein mentioned has employed, and now employs, persons who work in the following classifications: Cooks, shipping and receiving clerks, tow motor operators, drivers, machine operators and retort operators.

III.

Defendants Los Angeles Meat and Provision Drivers Union Local No. 626 and Teamsters, Chauffeurs, Warehousemen and Helpers of America Local 542 and Doe One Association to Doe Five Association (inclusive of all intervening numbers) are each labor organizations and are unincorporated associations in which employees participate and which exist for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, hours of employment and conditions of work.

Each of said defendant unincorporated associa-

tions is now, and at all times herein mentioned has been, composed of more than two persons residing in and associated in business under a common name, as above alleged, in the County of Los Angeles, State of California. All of said defendant labor organizations are associated with one another and with the American Federation of Labor.

IV.

Since on or about August 18, 1953, to the date of filing this complaint, plaintiff has each and every year produced and shipped in excess of \$250,000.00 worth of goods and materials to the States of Oregon, Washington, Nevada, Arizona and the Territory of Hawaii.

V.

Defendants Doe One Association to Doe Five Association (inclusive of all intervening numbers), defendants Doe One Corporation to Doe Five Corporation (inclusive of all intervening numbers) are fictitious names; said associations and corporations are sued herein by such fictitious names because their true names are unknown to plaintiff, and plaintiff will ask leave of court to amend this complaint and to substitute their true names when the same have been ascertained.

VI.

The specifically named defendants, and the fictitiously named defendants, and each of them, at all times herein mentioned, have been parties to the unlawful activities hereinafter alleged and have

been acting in concert and conspiracy with respect to the acts and matters hereinafter alleged and referred to.

VII.

On or about June 6, 1952, the National Labor Relations Board conducted an election among the employees of plaintiff for the purpose of determining the bargaining representative of plaintiff's employees. The Association of Independent Workers of America which at the time of the election was known as the Association of Pet Food Manufacturers Employees, won the election and was, and now is, certified as the bargaining representative of plaintiff's employees by the National Labor Relations Board.

VIII.

On or about the 11th day of September, 1952, plaintiff entered into a contract with the Association of Pet Food Manufacturers Employees, now known as the Association of Independent Workers of America, covering the wages, hours and working conditions of plaintiff's employees, which provided, among other things, that there would be no strike or work stoppage on the part of plaintiff's employees. Said contract was at all times herein mentioned, and presently is, in full force and effect.

IX.

On or about August 18, 1954, defendant Los Angeles Meat and Provision Drivers Union Local No. 626 did demand of plaintiff that plaintiff sign a contract covering plaintiff's employees who per-

form services in the various job classifications set forth in paragraph II of this complaint with respect to wages, hours and working conditions and did further demand that plaintiff recognize defendant Los Angeles Meat and Provision Drivers Union Local No. 626 as the exclusive bargaining agent of said employees of plaintiff and did claim that defendant Los Angeles Meat and Provision Drivers Union Local No. 626 has the exclusive right to have its members perform work for plaintiff.

X.

On or about August 19, 1954, defendants, with full knowledge that the Association of Independent Workers of America was, and is, the certified bargaining representative of the employees of plaintiff and, with full knowledge that plaintiff was and is signatory and party to a collective bargaining agreement with said Association, did establish a picket line at the place of business of plaintiff located at 817 East Eighteenth Street, City of Los Angeles, County of Los Angeles, State of California, and a picket line at the place or places of business of some of the persons with whom plaintiff was and is doing business and did on or about August 19, 1954, call a strike of plaintiff's employees and employees of some of the employers with whom plaintiff does business and, pursuant to said order of defendants to strike, approximately fifty of plaintiff's employees ceased working for plaintiff, and numerous employees of employers with whom plaintiff does business refused to work for their

employers. Many of plaintiff's employees who went on strike, pursuant to defendants' strike order, joined defendants' picket lines hereinbefore alleged and referred to, and carried picket signs which read:

"To the Public
Unfair to Organized Labor
Meat and Provision Drivers Union
Local 626 Teamsters AFL"

The number of persons participating as pickets in the picket line maintained by defendants at plaintiff's place of business, as herein alleged, consisted of as many as seventy persons at the deliver and customer entrances to plaintiff's place of business. Said pickets were massed at the entrances of plaintiff's place of business so closely together that persons and vehicles were blocked from proceeding into plaintiff's plant and were only able to do so when plant guards or officers of the Los Angeles Police Department cleared the entrances for the said persons and said vehicles; that said pickets on numerous occasions shouted foul and abusive language at persons entering and leaving plaintiff's place of business. During the said picketing, Charles Rico and Mike Singer, Business Representatives of defendant Los Angeles Meat and Provision Drivers Union Local No. 626, who were participating in said picketing, stopped a truck of plaintiff which was being driven away from plaintiff's place of business and beat up and injured two of plaintiff's employees who were in said truck.

XI.

On or about the 28th day of September, 1954, the Los Angeles Superior Court issued an injunction against defendant Los Angeles Meat and Provision Drivers Union Local No. 626, regulating the conduct of the picketing and limiting the number of pickets to two persons at each entrance to plaintiff's plant. A copy of said injunction is attached hereto as Exhibit "A" and incorporated herein.

XII.

As a direct and proximate result of the activities of the defendants, as hereinbefore alleged and referred to, defendants did engage in, and induce and encourage the employees of plaintiff and the employees of employers with whom plaintiff was and is doing business to engage in, a strike, or a concerted refusal, in the course of their employment, to use, manufacture, process, transport or otherwise handle or work on any goods, articles, materials or commodities or to perform any services for their employers.

XIII.

An object of the activities of the defendants hereinbefore alleged and referred to, during all times herein mentioned, was to force and require plaintiff to recognize or bargain with defendant Los Angeles Meat and Provision Drivers Union Local No. 626, as the representative of plaintiff's employees, notwithstanding another labor organization, to wit, the Association of Independent Workers of America, was and is certified as the representative of plain-

tiff's employees under the provisions of the National Labor Relations Act, and was for the further object of forcing or requiring employees with whom plaintiff was and is doing business to cease using, selling, handling, transporting or otherwise dealing in the product of plaintiff and to cease doing business with plaintiff.

XIV.

The picketing and strike, hereinbefore alleged and referred to, terminated on the 19th day of October, 1954, when an injunction was issued by Judge Peirson Hall of the United States District Court. A copy of the decree granting injunction is attached hereto as Exhibit "B" and incorporated herein.

XV.

On or about March 22, 1956, the National Labor Relations Board made and entered its decision against defendant Los Angeles Meat and Provision Drivers Union Local No. 626, pursuant to unfair labor practice charges filed by plaintiff, wherein said National Labor Relations Board did order said defendant union to cease and desist from picketing and striking plaintiff, or employers with whom plaintiff was and is doing business, all as set forth in the Decision and Order, which is attached hereto as Exhibit "C" and incorporated herein.

XVI.

On or about May 25, 1955, the United States Court of Appeals for the Ninth Circuit entered a decree against defendant Meat and Provision Driv-

ers Local Union No. 626, which ordered said defendant union to cease and desist from picketing or striking employers with whom plaintiff was and is doing business. A copy of said decree is attached hereto as Exhibit, "D" and incorporated herein.

XVII.

At all times since June 11, 1956, defendant Los Angeles Meat and Provision Drivers Union Local No. 626 has established and maintained a picket line at the place of business of plaintiff at 817 East Eighteenth Street in the City of Los Angeles, County of Los Angeles, State of California. The said picket line has for its purported purpose a protest against alleged plaintiff control over the certified union, to wit, the Association of Independent Workers of America. Plaintiff alleges that said purported purpose is a subterfuge and a sham and that the true purpose of said picketing is to engage in, or to induce or encourage the employees of plaintiff and employers with whom plaintiff does business to engage in, a strike or a concerted refusal in the course of their employment to use, manufacture, process, transport or otherwise handle or work on any goods, articles, materials or commodities, or to perform any services, an object thereof being to force or require plaintiff to recognize or bargain with said defendant union as the representative of plaintiff's employees notwithstanding another labor organization, to wit, the Association of Independent Workers of America, has been certified as the representative of plaintiff's

confederates should not be enjoined and restrained during the pendency of this action from the commission of certain acts as in the complaint filed in this action are particularly set forth and described; and hearing of said Order having come on regularly to be heard on the 20th day of September, 1954, in Department 34 of the above entitled Court and there being no appearance on behalf of the defendants and plaintiff having submitted the cause without argument, through their counsel, Hill, Farrer & Burrill, by Ray L. Johnson, Jr.; and the Court, having considered the evidence and points and authorities; and the Court, being fully advised in the premises, and good cause appearing therefor,

It Is Hereby Ordered, Adjudged and Decreed that during the pendency of this action, or until the final determination thereof, or until the Court shall otherwise order, the defendant Los Angeles Meat and Provision Drivers Union, Local No. 626, and defendant Mike Grancich, their officers, agents, representatives, members, employees, attorneys, pickets and confederates, and each of them, and all persons acting by, through or in concert with said defendants, and all persons acting in aid of or in conjunction with them, or any of them, are hereby restrained and enjoined pending the hearing of this order to show cause from doing or attempting or threatening to do or causing to be done, either directly or indirectly, by any means, method or device whatsoever, any of the following acts:

(a) Picketing, standing, sitting, loitering, gathering, assembling, marching, parading, walking, stopping or stationing, placing or maintaining any pickets, or other persons, at or near, around or in front of the entrances to plaintiff's place of business located at 817 East Eighteenth Street in the City of Los Angeles, County of Los Angeles, State of California, provided, however, that not to exceed two persons or pickets may be at or near, around or in front of each entrance to plaintiff's place of business, who must not obstruct the entrances or streets adjacent thereto.

(b) Intimidating, by threats of violence, molesting, restraining or interfering with any person who undertakes, attempts or makes known a desire or intention to report for work or to enter the place of business or upon the property of plaintiff, or their vehicles, or engaging in acts of violence or threatening acts of violence against any person whatsoever.

Bond on the preliminary injunction is fixed in the sum of \$1,000.00.

Dated: This 28th day of September, 1954.

/s/ ARNOLD PRAEGER,

Judge of the Superior Court.

EXHIBIT "B"

United States District Court, Southern District
of California, Central Division

Civil No. 17286 PH

George A. Yager, Acting Regional Director of the
Twenty-First Region of the National Labor
Relations Board, for and on behalf of the Na-
tional Labor Relations Board, Petitioner,

vs.

Meat & Provision Drivers Union, Local No. 626, In-
ternational Brotherhood of Teamsters, Chauff-
eurs, Warehousemen & Helpers of America,
AFL, Respondent.

DECREE GRANTING INJUNCTION

This cause came on to be heard on the verified petition of George A. Yager, Acting Regional Director for the Twenty-First Region of the National Labor Relations Board, on behalf of the Board, for a temporary injunction pending final adjudication of the Board of the matters involved, and upon issuance of a rule to show cause why injunctive relief should not be granted as prayed in the petition. The Court, upon consideration of the petition, answer, testimony, evidence, briefs and the entire record and argument of counsel for the parties, duly made and entered Findings of Fact and Conclusions of Law.

It is, therefore, by this Court ordered, adjudged and decreed that:

1. Respondent, Meat & Provision Drivers Union, Local No. 626, International Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of America, AFL, its agents, members, servants, employees, attorneys and all persons in active concert or participation with it, be and they hereby are, restrained and enjoined, pending the final adjudication of this matter by the National Labor Relations Board from:

(a) Engaging in a strike or picketing at the plant of Lewis Food Company.

(b) By any means, including picketing, or by permitting any such to remain in existence or effect, engaging in, or inducing or encouraging the employees of Lewis Food Company, its customers or suppliers or of any other employer to engage in, a strike or a concerted refusal in the course of their employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities, or to perform any service, where an object thereof is to force or require Lewis Food Company to recognize or bargain with Respondent or any other labor organization as the collective bargaining representative of any of the employees in the unit for which Association of Pet Food Manufacturers Employees is the certified representative.

2. This injunction shall remain in effect until the matters involved have been adjudicated by the National Labor Relations Board.

3. This Decree Granting Injunction, together with a copy of the Findings of Fact and Conclusions of Law upon which it is issued, shall be served by a United States Marshal upon the Respondent, Meat & Provision Drivers Union Local No. 626, International Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of America, AFL.

Dated at Los Angeles, California this 19th day of October, 1954.

PEIRSON HALL,

United States District Judge.

[Note: Exhibits "C" and "D", the Decision and Order, Order Correcting Decision and Order, and Decree are reported in 115 NLRB No. 136. They are omitted here for reasons of economy.]

[Endorsed]: Filed August 17, 1956.

[Title of District Court and Cause.]

ANSWER TO COMPLAINT FOR DAMAGES AND PLEA IN ABATEMENT

Comes now, Defendant, Los Angeles Meat and Provision Drivers Union Local No. 626 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, an unincorporated association, and pleading to the complaint herein, it:

I.

Denies each and every averment contained in

Paragraphs VI, IX, XII, XIII, XVIII, XIX and XX.

II.

Is without knowledge or information sufficient to form a belief as to the truth of the averments contained in Paragraph VIII.

III.

Answering Paragraph VII, admits that the Association of Independent Workers of America was certified, after an election, by the National Labor Relations Board on June 6, 1952, but denies every other allegation of fact contained in this paragraph and specifically denies that said certification was, at any time, valid and legally binding because:

(1) Said Association and its successor, at all times referred to in the complaint, were and are company unions formed, dominated, assisted and financed by Plaintiff in violation of Section 8 (a) (2) of the National Labor Relations Act as amended;

(2) No valid election or certification was held or issued because said Association was not, at the time of the organization or certification, in compliance with the requirements of Section 9 (f) (g) and (h) of the said Act;

(3) The National Labor Relations Board did, on April 30, 1956, issue its formal complaint against the Plaintiff and the Association in Board cases numbered 21-CA-2061, 2203 and 21-CB-708, wherein and whereby said Board, through its General Coun-

sel, charges that the Association was at all times a company union as alleged in subparagraph (1) above. The Board has opened a hearing upon said complaint and is now in the process of taking evidence for the purpose of adjudicating whether or not said Association is, or ever was, a bona fide labor organization within the meaning of said Act and whether the certification issued to it as a bargaining representative of Plaintiff's employees was or is valid and binding.

IV.

Answering Paragraph X, Defendant admits that between August 19 and October 19, 1954 it engaged in peaceable picketing at the place of business of Plaintiff at 817 East 18th Street in Los Angeles, California and that said pickets carried signs bearing the legend set forth in the complaint but denies each and every other allegation contained in this paragraph of the complaint.

V.

Answering Paragraph XVII, Defendant admits that it established a second picket line at the place of business of Plaintiff on or about June 11, 1956 and continues the same at this time, which said picket line had and has for its purpose the publicizing of a protest against the Plaintiff's unfair labor practices in establishing, dominating and controlling the Association; that the legend carried by pickets in connection with this second picket line clearly discloses that it represents a protest against the unfair labor practices which are the subject of

the aforesaid outstanding complaint of the National Labor Relations Board against the Plaintiff and the Association, but denies each and every other allegation of fact contained in this paragraph of the complaint.

VI.

Each and all of the allegations contained in Paragraphs XI, XV and XVI of the complaint are redundant, immaterial and have no bearing upon the cause of action sought to be pleaded in the complaint.

Plea in Abatement

I.

The trial and all other proceedings in this case should be abated and no further proceedings held herein because a controlling substantial issue upon which the complaint is based, that is, the legal validity of the Labor Board Certification issued in 1952 to the Association, is presently in the process of adjudication by the National Labor Relations Board, whose primary jurisdiction to decide such matters is exclusive.

II.

After the National Labor Relations Board had issued its certification to the Association and after it had implemented said certification by injunction and unfair labor practice proceedings against Defendant, as alleged in the Complaint, the Regional Office of the National Labor Relations Board investigated charges filed with it by defendant and an individual and concluded that sufficient evidence existed to justify the issuance of a formal com-

plaint against the Plaintiff and the Association. Such complaint was duly issued on April 30, 1956 in Case 21-CA-2061, 2203 and 21-CB-708 which said complaint, in part, alleges the following:

“9. The Employer since on or about January, 1952, has dominated and interfered with the formation and administration of the Association and has contributed financial and other support to the Association.”

“10. The Employer since on or about February 27, 1954, to date, has dominated, assisted and contributed to the support of, and interfered with the administration of the Association.”

III.

On June 11, 1956, hearings on the aforesaid complaint were begun before Board Trial Examiner Wallace Royster at the Board offices in Los Angeles, California, at which hearings the Plaintiff was represented by Counsel and fully participated. On the first day of such hearing a number of officials of Defendant and of the Association refused to be sworn as witnesses or to produce documents in accordance with subpoenas which had earlier been served upon them at the request of Counsel for the General Counsel of the National Labor Relations Board and, because of this fact, Counsel for the Board requested and obtained an indefinite postponement of the resumption of said hearings before said Trial Examiner in order to give him an opportunity to apply for an order from this United States District Court compelling obedience

to said subpoenas. Said hearings, solely for said reason, have continued in recess at all times to the present date.

IV.

On June 29, 1956 a proceeding entitled National Labor Relations Board, Applicant vs. D. B. Lewis, President, Lewis Food Company, et al (Civil No. 20119-TC) was filed in this Court, having for its purpose the obtaining of an order of obedience to the aforesaid subpoenas. Following the issuance of an order to show cause and hearings thereon, an order was entered as shown by the records of this Court denying enforcement of such subpoenas.

V.

Within due time, the National Labor Relations Board appealed the judgment of this District Court denying enforcement of its subpoenas and the entire case is now pending before the Court of Appeals for the Ninth Circuit.

VI.

Defendants have repeatedly been informed by Counsel for the National Labor Relations Board that its current unfair labor practice proceedings against the Plaintiff and its Association will be resumed upon the conclusion of the litigation respecting the validity of the Board's subpoenas and that the Board, through its General Counsel, will continue its efforts to establish that the Association is and at all times, both before and after its certification, was a company union formed in violation of Section 8 (a) (2) of the Act. Under the provisions of Section 10 (a) of the Act, the Board

is empowered upon a finding that unfair labor practices have been committed, to enter a remedial order which will effectuate the purpose of the Act. Routinely, the Board in the past has entered an order requiring a company to cease and desist from giving effect to any certification of a union or any contract with a union made pursuant to a certification, whenever the Board has found that such union was a company dominated or assisted union. Accordingly, should the Board in its current proceedings ultimately find in accordance with the General Counsel's complaint and defendant's contentions, that Plaintiff formed, dominated, assisted and is dominating and assisting the Association, the Board will order the certification vacated and will order the company and the Association to cease giving any effect whatsoever to said certification. Such an order by the Board would render the certification null and void ab initio and thereby make it lawful for any union to have engaged in picketing against such void certification.

VII.

A substantial issue exists under the pleadings in this case as to whether or not the Association had or has a valid certification of bargaining rights covering plaintiff's employees. Since the National Labor Relations Board is currently adjudicating the same matter and will ultimately determine the validity of its 1952 certification, this Court either lacks jurisdiction to adjudicate the same subject matter or, in the alternative, as a matter of comity,

this Court should defer the trial of this issue until the Labor Board has made a final and binding adjudication.

VIII.

The other issues posed by the complaint in this case cannot be adjudicated separately from the issue of the bona fides of the Association without the parties, and this defendant in particular, being subjected to the piecemeal and inconclusive trial of the action.

Wherefore, defendant prays:

1. That this action be abated and no further proceedings be taken until the National Labor Relations Board has issued a final and binding decision in its cases numbered 21-CA-2061, 2203 and 21-CB-708.

2. That the Plaintiff take nothing by its complaint and that the same be dismissed in its entirety.

3. That Defendant recover its costs herein.

STEVENSON & HACKLER,

/s/ By CHARLES K. HACKLER,

Attorneys for Los Angeles Meat and Provision
Drivers Union No. 626.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed September 5, 1957.

MINUTES OF THE COURT

Date: February 17, 1958. At: Los Angeles, Calif.

Present: Hon. Leon R. Yankwich, District Judge.

Deputy Clerk: L. Cunliffe. Reporter: Virginia Wright.

Counsel for Plaintiff: Ray Johnson, Esq.

Counsel for Defendant: Charles Hackler, Esq.

Proceedings: Hearing on:

1. Pre-trial conference and setting.

It Is Ordered that the above be vacated and set aside.

2. Defendant's motion for abatement:

After extensive argument from both counsel, It Is Ordered that the matter stand submitted.

Filed at request of plaintiff, N.L.R.B. Order of Trial, and at request of defendant, N.L.R.B.'s consolidated complaint and order consolidating cases for trial.

JOHN A. CHILDRESS,
Clerk,

/s/ By L. CUNLIFFE,
Deputy Clerk.

United States District Court, Southern District
of California, Central Division

No. 2033-Y

LEWIS FOOD COMPANY, a California Corpo-
ration, Plaintiff,

vs.

LOS ANGELES MEAT AND PROVISION
DRIVERS UNION LOCAL No. 626 OF
THE INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFEURS, WARE-
HOUSEMEN AND HELPERS OF AMER-
ICA, an unincorporated association; TEAM-
STERS, CHAUFFEURS, WAREHOUSE-
MEN AND HELPERS OF AMERICA
LOCAL 542, an unincorporated association,
et al., Defendants.

MEMORANDUM OPINION AND ORDER

Yankwich, District Judge:

The Complaint filed on August 17, 1956, by the plaintiff, a California corporation engaged in manufacturing, producing, distributing and selling pet foods, seeks damages against two local unions under Section 187 of Title 29 U.S.C.A.

In substance, the Complaint alleges that the defendants Los Angeles Meat and Provision Drivers Union Local No. 626 and Teamsters Local 542, labor organizations, have maintained an illegal picket line at a place of business of the plaintiff

at 817 East 18th Street, in the City of Los Angeles, County of Los Angeles, State of California, and called a strike of some of the plaintiff's employees. This is alleged to be in violation of an Order of the National Labor Relations Board made pursuant to an election conducted by the Board on or about June 6, 1952, among the employees of the plaintiff for the purpose of determining the bargaining representative of the plaintiff's employees.

The Association of Independent Workers of America, which, at the time of the election, was known as the Association of Pet Food Manufacturers Employees,—to be referred to as “the Association”—won the election, and was, on that day, certified as and now is certified as the bargaining representative for plaintiff's employees by the National Labor Relations Board,—to be referred to, at times, as “the Board”.

On or about the 11th day of September, 1952, plaintiff entered into a contract with the Association covering the wages, hours and working conditions of its employees, which provided, among other things, that there would be no strike or work stoppage on the part of plaintiff's employees. The contract was, at all times herein mentioned and presently is, in full force and effect.

Subsequent to that date, the defendant unions conducted acts of strike and picketing between August 19 and October 19, 1954, which picketing was renewed on June 11, 1956. The intervening facts may be summed up briefly in this manner: In early

August, 1954, Local 626 began organizational efforts among the plaintiff's employees and on August 19 engaged in peaceable picketing of plaintiff's place of business in Los Angeles, California. Such picketing continued until October 19, 1954, at which time it was enjoined by the Order of this Court issued in the case of *Yager v. Meat and Provision Drivers Local Union*, Civil No. 17286-PH. Thereafter, on March 22, 1956, the Board, in case number 21-CC-190, entered its decision finding that the Union had, by such picketing, violated Section 8(b)(4)(c) of the National Labor Relations Act, in that the picketing was found to be directed against the bargaining rights of the Association as a certified union. On May 2, 1956, an Order was entered in case number 17826-PH dissolving this court's injunction, and on November 14, 1956, the Board notified all parties that the union had satisfactorily complied with the Board's order in its case number 21-CC-190. Meantime, on March 29, 1955, a person named Otto A. Roth filed charges against the plaintiff and the Association claiming that the latter was an illegally dominated organization within the meaning of Section 8(a)(2) of the National Labor Relations Act. (21-CA-2203 and 21-CB-708) Local 626 had itself lodged similar company union charges as early as August 27, 1954. Both of these charges remained under investigation by the Regional Office of the Board during all of the Board and Court proceedings described above.

On April 30, 1956, the Board issued a formal

complaint against the plaintiff and the Association, based upon the last mentioned charges which alleges, in part, the following:

“9. The Employer since on or about January, 1952, has dominated and interfered with the formation and administration of the Association and has contributed financial and other support to the Association.

“10. The Employer since on or about February 27, 1954, has dominated, assisted and contributed to the support of, and interfered with the administration of the Association.”

Since June, 1956, Local 626 has maintained a picket line at the place of business of the plaintiff, allegedly in protest against plaintiff's control over the certified Association. The Complaint alleges that the true purpose of the picketing is

“to engage in, or to induce or encourage the employees of the plaintiff and employers with whom plaintiff does business to engage in, a strike or a concerted refusal in the course of their employment to use, manufacture, process, transport or otherwise handle or work on any goods, articles, materials or commodities, or to perform any service, an object thereof being to force or require plaintiff to recognize or bargain with said defendant union as the representative of plaintiff's employees notwithstanding another labor organization, to-wit, the Association of Independent Workers of America, has been certified as the representative of plaintiff's employees under the provisions of the National Labor Relations Act.” (Complaint, par. XVII)

After averring that the acts and conduct of the defendants relate to trade, traffic and commerce among the several states, and have led to a labor dispute burdening and obstructing commerce and the free flow of commerce, and that it was done maliciously, the Complaint seeks actual damages in the sum of \$300,000.00 and exemplary damages in the sum of \$50,000.00.

It is not necessary, for the purposes of this opinion, to outline the Answer filed on behalf of Local 626, which admits many of the facts just outlined. It is sufficient to state that, in the main, it seeks to avoid the consequences of the acts by alleging that the object of the present proceedings instituted before the Board is to declare that the Association is not only dominated by the employer at the present time, but was so dominated at the time of, and prior to, the certification on June 6, 1952.

Invoking the doctrine of "primary jurisdiction", the Answer sets forth a plea in abatement, in which it is claimed that, because of the nature of the present proceedings, the Board might, in a new Order, declare that employer domination existed at the time of the certification. For this reason, it is urged that the action be abated and

"* * * no further proceedings be taken until the National Labor Relations Board has issued a final and binding decision in its cases numbered 21-CA-2061, 2203 and 21-CB-708".

The defendants argues that because of the subsequent proceeding attacks the correctness of the cer-

tification of the Association as bargaining representative, this action, which seeks damages by reason of unfair labor practices for alleged picketing and encouragement of strikes while the plaintiff had a contract with the certified union, (29 U.S.C.A., §187(b)) should abate and abide the decision of the Board in the new proceeding.

The argument is without merit. Section 187 of 29 U.S.C.A. creates a private right of action in favor of the employer to recover damages against any union guilty of any of the unfair practices denounced in the other subdivisions of the Section. The Supreme Court has held that the remedy is not

“dependent on any prior administrative determination that an unfair labor practice has been committed. Rather, the opposite seems to be true.” (*International Longshoremen’s & Warehousemen’s Union v. Juneau Spruce Corp.*, 1952, 342 U.S. 237, 244)

Rightly. For the remedy of the employer is independent of any action the Board may take to enforce the same provision. The action is akin to the private action for treble damages by persons injured by the violation of the anti-trust laws of the United States, (15 U.S.C.A., § 15) in addition to the remedies by criminal action and civil action instituted by the Government. (15 U.S.C.A., §§ 1-5)

It is true that the National Labor Relations Board, after certifying a bargaining representative, may, after the lapse of a twelve-months period, revoke the certification, disestablish the certified

union, and certify another. (29 U.S.C.A., § 159(c) (3); *Wallace Corporation v. National Labor Relations Board*, 1944, 323 U.S. 248, 249; *National Labor Relations Board v. Gilfillan Bros.*, 9 Cir., 1945, 148 F. 2d 990, 991) Subject to judicial review to enforce unfair labor practice orders, the issuance or the revocation of certification is entrusted expressly and solely to the Board. However, as stated by the Court of Appeals for the Fifth Circuit:

“Whether or not the Union has lost that status is for the Board to determine upon orderly statutory procedure.” (*National Labor Relations Board v. Sansone Hosiery Mills*, 5 Cir., 1952, 195 F. 2d 350, 353-354)

An existing certificate must be honored by both sides until it is lawfully rescinded. (*Brooks v. National Labor Relations Board*, 1954, 348 U.S. 86, 103)

There is unanimity among the Courts in giving recognition to this principle. As said by the Court of Appeals for the Sixth Circuit:

“* * * the decisive thing is the certification by the Board. Until by Board action it is effectually extinguished, it has continued vitally to protect an employer against a raiding rival whose objective is ‘forcing or requiring [such] employer to recognize or bargain with * * * [it] * * * as the representative of [his] employees * * *’” (*Parks v. Atlanta Printing Pressmen and Assistant’s Union*, 5 Cir., 1957, 243 F. 2d 284, 290)

In the light of these rulings, we cannot apply, as the union would have us do, in this area, principles which command courts to defer action while administrative action involving the same matter is pending. The cases invoked involve entirely different situations, arising out of dissimilar relationships in instances in which the administrative agency has exclusive jurisdiction.

Thus, in *General American Tank Car Corp. v. Eldorado Terminal Co.*, 1940, 308 U.S. 422, an action on a contract between a shipper and a railroad was stayed while there was pending before the Interstate Commerce Commission the question of the validity of the contract as an unlawful rebate under the Interstate Commerce Act.

In *Far East Conference v. United States*, 1952, 342 U.S. 570, an action by the Government for alleged violation of the Sherman Anti-Trust Law by steamship owners was ordered dismissed because the Federal Maritime Board had initial jurisdiction of the matter.

In all these cases there were pending before the Administrative Board the determination of facts which, when finally determined, would not only affect, but control the actions before the courts involving similar facts. So the Courts applied what is known as the primary jurisdiction doctrine under which Courts will not determine a matter which is within the exclusive jurisdiction of an administrative agency, while the same question is pending before the agency. (See, *Rochester Telephone Corp. v. United States*, 1939, 307 U.S. 125, 139; *Thomp-*

son v. Texas Mexican Ry. Co., 1946, 328 U.S. 134, 146-151) But in none of these cases were we confronted with a statute giving to a person the right of action for past occurrences, the nature of which could not possibly be affected by future administrative action.

The summary of the cases just given shows clearly the distinction. This may be further illustrated by *Nathanson v. National Labor Relations Board*, 1952, 344 U.S. 25, also cited by the defendants. There, the National Labor Relations Board had ordered the Company to pay back-pay. After an involuntary petition in bankruptcy was filed, the Court of Appeals ordered the Order enforced. The Board then filed a proof of claim for the back-pay. The Supreme Court held that the bankruptcy court should not assume to determine the validity of the claim, but rather the Board should have the final determination, saying:

"It is the Board, not the referee in bankruptcy nor the court, that has been entrusted by Congress with authority to determine what measures will remedy the unfair labor practices. We think wise administration therefore demands that the bankruptcy court accommodate itself to the administrative process and refer to the Board the liquidation of the claim, giving the Board a reasonable time for its administrative determination." (p. 30) (Emphasis added)

The Supreme Court, in a case decided on February 3, 1958, has warned that, while the power of the National Labor Relations Board in disestab-

lishing a union as dominated by an employer is broad, it is "not limitless" (National Labor Relations Board v. District 50, United Mine Workers of America and Bowman Transportation, Inc., No. 64, October Term, 1957, slip decision, p. 4)

In the case before us, the Board not only certified the Association, but rejected contentions made by the same unions who are appearing here that the Association was employer-dominated. It follows that even if the Board, in the present proceedings, should hold that the Association is union dominated and disestablish it, this could not affect its prior certification of June 6, 1952, so as to deprive the employer who complied with it, as he was required to do, of the right to prove in this Court that between the date of the original certification and before its revocation, the union by its actions, caused him damage. To hold otherwise, would make the remedy of the employer illusory. For he could never depend on the finality of the certification in instituting an action for damages.

We are bidden to avoid interpreting a statute retrospectively unless the Congress has specifically indicated a clear intention to so apply it. As said in a leading case:

"Statutes are not to be given retroactive effect or construed to change the status of claims fixed in accordance with earlier provisions unless the legislative purpose so to do plainly appears." (United States v. Magnolia Petroleum Co., 1928, 276 U.S. 160, 162-163)

(And see, *Hassett v. Welch*, 1938, 303 U.S. 303, 314.)

In *Claridge Apartments Co. v. Commissioner*, 1944, 323 U.S. 141, 164, the Court summed up the principle in this pithy manner:

“Retroactivity, even where permissible, is not favored, except upon the clearest mandate.”

Concededly, the Congress, in matters dealing with the employer and employee relationship, may take away a right it has previously conferred, as happened with the passage of the Portal-to-Portal Act (29 U.S.C.A., §§ 251-262), and to give to it retroactive effect. (*Battaglia v. General Motors Corp.*, 2 Cir., 1948, 169 F. 2d 254, 259-262; *Thomas v. Carnegie-Illinois Steel Corp.*, 3 Cir., 1949, 174 F. 2d 711) Nevertheless, the Congress, in establishing the private remedy involved in this action, has not shown any intention to do so. The Congress, by giving the right of action to any employer injured by the provisions of Subsection (a) of Section 187, Title 29 U.S.C.A., used the imperative throughout: “Whoever shall be injured in his business or property” is given the right to sue, and “shall recover the damages by him sustained.” So that, while it is given to the employer to determine whether he will sue, once he has been injured, and exercised that right, he is entitled to such damages as he may establish judicially to have suffered from the forbidden acts. No subsequent action by the Board relating to certification could deprive the employer of the right he has acquired to sue on

which, in defiance of a certification which has become final, has damaged his business or property.

Where two remedies have been given by the Congress, the Courts will enforce both, although one be administrative and the other judicial, unless the language of the statute is clear enough to bring the case within the purview of the primary jurisdiction doctrine already referred to, the foundation for which was laid by the Supreme Court in 1907, in *Texas & Pacific Ry. Co. v. Abilene Cotton Oil Co.*, 1907, 204 U.S. 426, 440-442. Thus, where the United States brought action under Section 15 of the Clayton Act (15 U.S.C.A., § 25) to enjoin the violation by several corporations of the provision against interlocking directorates contained in Section 8 of the Act, (15 U.S.C.A. §19) the Supreme Court rejected the contention that because Section 11 of the same Act (15 U.S.C.A., § 21) allows the Interstate Commerce Commission to enforce the section, the action could not be entertained, by stating:

“Section 11 does authorize the Commission to enforce §8. But any inference that administrative jurisdiction was intended to be exclusive falls before the plain words of §15: ‘The several district courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this Act * * *’ 38 Stat. 736, 15 U.S.C. & 25. And the cases have spoken of Congress’ design to provide a scheme of dual enforcement for the Clayton Act.” (*United States v. W. T. Grant Co.*, 1953, 345 U.S. 629, 631-632)

In the matter before us, it is quite evident that the Congress intended to grant to the employer a right of action for damages which the Supreme Court has stated is not tied to, or dependent on, the status of administrative proceedings relating to the same controversy before the National Labor Relations Board. (*International Longshoremen's & Warehousemen's Union v. Juneau Spruce Corp.*, 1952, 342 U.S. 237, 244). The object of statutes of this character is to aid the furthering of the social policy of the law by providing a private action by an individual for damages caused by the violation of the Act,—as in the case of a private action for treble damages for violation of the anti-trust laws. (15 U.S.C.A., § 15) (And see the writer's opinions in *Balian Ice Cream Co. v. Arden Farms Co.*, 1950, D.C. Calif., 94 F. Supp. 796, 801, and cases cited in Notes 20, 21 and 22 thereof; *Fanchon & Marco v. Paramount Pictures, Inc.*, 1951, D.C. Calif., 100 F. Supp. 84, 88, and cases cited in Footnote 5)

So, granting that the National Labor Relations Act constitutes a complete scheme for the determination of labor and management disputes affecting interstate commerce, which leaves no room for judicial intervention except by way of enforcement of the Board's orders by the Courts of Appeals, (*Myers v. Bethlehem Ship Building Corporation*, 1938, 303 U.S. 41, 47-50. And see, the writer's opinion in *Northrop v. Madden*, 1937, D.C. Calif., 30 F. Supp. 993, 995) the Congress must be presumed to have envisaged the situation in which a private court action might be pending at the same time as

an administrative action. Having authorized both actions, it is our duty to give them full effect. The more so, as any future determination by the Board as to certification could not affect the present action. The reason is obvious. The acts of which the employer complains in this action occurred at the time when the employer was required to comply with the action of the Board in certifying the Association as a bargaining agent. If he was damaged by the action of the union defendants in this case, he is entitled to recover even though by later action the Board should disestablish the Association and recognize another collective bargaining representative.

The Motion to Abate will be denied.

Dated: March 3, 1958.

/s/ LEON R. YANKWICH,

Chief U. S. District Court Judge.

[Endorsed]: Filed March 3, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Los Angeles Meat and Provision Drivers Union Local No. 626 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, an unincorporated association, defendant above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the order made by Honorable Leon R. Yankwich denying defendant's

motion to abate the above entitled action, said order being entered on March 3, 1958.

Dated: March 26, 1958.

STEVENSON & HACKLER,
/s/ By HERBERT M. ANSELL,
Attorneys for Appellant.

Proof of Service by Mail Attached.

[Endorsed]: Filed March 31, 1958.

[Title of District Court and Cause.]

APPLICATION FOR ORDER EXTENDING
TIME TO FILE AND DOCKET RECORD
ON APPEAL

Defendant and appellant respectfully requests this court to extend their time to file and docket the record on appeal with the Court of Appeals up to and including May 25, 1958.

This application is based upon the attached affidavit of Herbert M. Ansell, and upon all pleadings in the above entitled action.

STEVENSON & HACKLER,
/s/ By HERBERT M. ANSELL,
Attorneys for Defendant Local
626.

Dated: May 15. It Is So Ordered.

/s/ BURT HARRISON,
Judge.

AFFIDAVIT OF HERBERT M. ANSELL

State of California

County of Los Angeles—ss.

Herbert M. Ansell, being first duly sworn, deposes and says:

I am associated with the firm of Stevenson & Hackler, counsel for defendants in the above entitled case.

On March 31, 1958, defendants filed their Notice of Appeal from the order of Judge Leon Yankwich denying defendants' motion to abate the above entitled action until the National Labor Relations Board concluded its Case No. 21-CA-2061, 2203 and 21-CB-708.

Defendants on April 21, 1958, designated as part of the record, the transcript of oral argument rendered by counsel at the time of the said motion.

On May 12, 1958, defendants' counsel were notified by William A. White, Deputy Clerk, by letter dated May 9, 1958, that since the forty (40) day period for filing and docketing expired on May 10, 1958, and since the reporter's transcript of oral argument was not filed with the clerk, it would be necessary to renew an extension of time to allow preparation of the record.

Appellants have since receiving this notice informed Mr. White that they are willing to delate the transcript of oral argument as part of the designated record. Mr. White thereupon informed affiant that the record could be docketed in about ten (10) days.

Further affiant sayeth not.

/s/ HERBERT M. ANSELL.

Subscribed and Sworn to before me this 13th day
of May, 1958.

[Seal] /s/ W. NEAL WRITTER,

Notary Public in and for said
County and State.

[Endorsed]: Filed May 15, 1958.

[Note: The Intermediate Report and Recommended Decision and Decision of National Labor Relations Board in Case No. 21-CC-190 are reported fully in 115 NLRB No. 136 (March 22, 1956). They are not reproduced here for reasons of economy.]

United States of America (Copy)
National Labor Relations Board

CHARGE AGAINST EMPLOYER

* * * * *

Case No. 21-CA-2061. Date Filed: 8-27-54. Compliance Status Checked By: /s/ HA.

1. Employer Against Whom Charge Is Brought:
Name of Employer: Lewis Food Company.

Address of Establishment: 817 East 8th Street, Los Angeles, California.

The above-named employer has engaged in and is engaging in unfair labor practices within the meaning of section 8 (a), subsections (1) and 8(a)2 of the National Labor Relations Act, and these unfair labor

practices are unfair labor practices affecting commerce within the meaning of the act.

2. Basis of the Charge:

The following persons were discharged for Union activity and specifically because they had made application to join Local Union No. 626:

Joseph Flores—1203 West 31st Street, Los Angeles 7, California:

Applied for membership about August 7th. Had worked at plant 60 days without any complaint whatever on his work. The guard at the door who admits employees, had a list, upon which was marked the names of certain people to be discharged. As they entered the plant, the guard checked this list, and from this check directed them to the office to be discharged.

Jesus Carabajal—641 N. Merida Avenue, Los Angeles 22, California:

Employed six months—applied for Union membership about August 1st; discharged about August 15th. No complaints whatever on his work. Guard instructed him to pick up final check.

Antonio Flores—5912 Woodlawn Avenue, Los Angeles, California:

Employed three and one-half years—no complaints on his work. Applied for membership with the Union about July 15th; discharged Monday, August 8th, after meeting of employees in Teamsters' group the previous Friday. Taken to office by Nathan Lewis, brother of the plant owner, and Joe Luera, foreman,

from his machine while working about 3:30 P. M. No complaints on work. This man, while waiting in the office, overheard the President of the Company Association, Walt Smith, talking to the owners in an adjoining room. Smith told the owner they were going to fire all the men who had joined the Teamsters' Union, and that five or six men were on the list for discharge the next day. Smith was telling the members who to fire.

Salvadore Jiminez—824 E. 18th Street, Los Angeles
21, California:

Worked at Lewis six years and five months. About four days prior to August 14th, was requested to break in a new man for four days, and applied for membership in the Union in July—discharged on August 14th.

Lewis Perez—2843 Blanchard Street, Los Angeles
33, California:

Employed 14 months. Filed Union application about August 7th; discharged August 11th. No complaints on his work. Was told nothing as cause for discharge. Guard instructed him to go to the office after consulting a list which he had containing names of men to be fired. The guard said: "You are one of them—go to the office." Employer had him break in a man on his machine the day previous.

Jesus Serrano—5847 S. Denver Avenue, Los Angeles
44, California:

Employed two months—no complaints on work. Applied for membership on August 11th—discharged

two days later, on August 13th. Foreman Joe Luera gave no reason for discharge, simply stated he had replacement for him. Following these discharges, workers struck on August 19th, in protest against discharges for Union activity, and have picketed ever since.

Wednesday, August 25th:

Company fired 20 strikers as they came into the plant to get their pay checks. In the succeeding three days, as strikers went to get their checks, 25 more were discharged. Horace Lewis, brother of owner in charge of warehouse, came out to picket line and asked two employees to return to work on Thursday, August 26th. These men did not return to work. They were Jose Vracamonte of 3339 E. 4th Street, Los Angeles, California, and Casmiro Lovato, Jr., of 3011 E. 5th Street, Los Angeles, California.

This strike is solely in protest against unfair labor practices in discharges.

3. Full Name of Labor Organization, Including Local Name and Number, or Person Filing Charge: Meat & Provision Drivers, Local Union No. 626.

4. Address: 846 South Union Avenue, Los Angeles, California. Telephone No.: DU. 7-3359.

5. Full Name of National or International Labor Organizations of Which It Is an Affiliate or Constituent Unit: International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, A.F.L.

6. Address of National or International, if any:
100 Indiana Avenue, N.W., Washington, D. C.

7. Declaration:

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

By /s/ CHARLES RICO,

Business Representative of Local 626.

August 27th, 1954.

United States of America (Copy)
National Labor Relations Board

CHARGE AGAINST EMPLOYER

* * * * *

Case No. 21-CA-2203. Date Filed: 3-29-55.

1. Employer Against Whom Charge Is Brought:

Name of Employer: Lewis Food Company.

Number of Workers Employed: 500.

Address of Establishment: 817 East 18th Street,
Los Angeles 21, California.

Type of Establishment: Cannery.

Identify principal product or service: Animal Food.

The above-named employer has engaged in and is engaging in unfair labor practices within the meaning of section 8 (a), subsections (1) and (2) and (3) of the National Labor Relations Act, and these unfair labor practices are unfair labor practices affecting commerce within the meaning of the act.

Food Company in their rights guaranteed in Section 7 of the Act.

3. Name of Employer: Lewis Food Company.

4. Location of Plant Involved: 817 East 18th Street, Los Angeles 21, California.

5. Type of Establishment: Cannery.

6. Identify Principal Product or Service: Animal Food.

Number of Workers Employed: 500.

8. Full Name of Party Filing Charge: Otto A. Roth.

9. Address of Party Filing Charge: 15619 Septo Street, San Fernando, California.

10. Telephone Number: (None).

11. Declaration:

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

By /s/ OTTO A. ROTH,

An Individual.

March 29, 1955.

United States of America

Before The National Labor Relations Board
Twenty-First Region

Case No. 21-CA-2061

Lewis Food Company and Meat and Provision Drivers, Local Union No. 626, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, AFL-CIO.

Case No. 21-CA-2203

Lewis Food Company and Otto A. Roth, An Individual.

Case No. 21-CB-708

Association of Food Handlers, a/k/a Association of Pet Food Manufacturing Employees, a/k/a Association of Pet Food Manufacturers Employees, a/k/a Association of Independent Workers and Otto A. Roth, An Individual.

CONSOLIDATED COMPLAINT

It having been charged by the Meat and Provision Drivers, Local Union No. 626, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, AFL-CIO, hereinafter referred to as the Union, and by Otto A. Roth, an individual, that Lewis Food Company, hereinafter referred to as the Employer, and the Association of Food Handlers, also known as Association of Pet Food Manufacturing Employees, also

known as Association of Pet Food Manufacturers Employees, and also known as Association of Independent Workers, hereinafter referred to as the Association, and each of them, have engaged in and are engaging in certain unfair labor practices affecting commerce as set forth and defined in the National Labor Relations Act, as amended, Public Law 101, 80th Congress, First Session, hereinafter called the Act, and the General Counsel of the National Labor Relations Board, on behalf of the Board, having issued an Order of Consolidation, the Regional Director for the Twenty-First Region, designated by the Board's Rules and Regulations, Series 6, as amended, Section 102.15, hereby issues this Consolidated Complaint and alleges as follows:

1. The Employer, a California corporation, is engaged at Los Angeles, California, in the manufacture of pet foods. The Employer annually sells and ships products valued at in excess of \$250,000 from its Los Angeles, California, plant to points and places outside the State of California.

2. The Employer is, and at all times material herein has been, engaged in commerce within the meaning of the Act.

3. The Union is a labor organization within the meaning of Section 2, subsection (5) of the Act.

4. The Association is a labor organization within the meaning of Section 2, subsection (5) of the Act.

5. On or about March 23, 1955, the Association, through its officer, Walter Schmidt, restrained and coerced Otto A. Roth, an employee of the Em-

ployer, in the exercise of his right under Section 7 of the Act to refrain from joining or assisting the Association and to bargain collectively through the Association and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection in that, among other things, the Association, through its officer, Walter Schmidt, caused the Employer to deduct from the wages of said Otto A. Roth an initiation fee and dues against the will of Otto A. Roth and although said Roth had been employed less than 30 days.

6. On or about March 24, 1955, the Association, through said Walter Schmidt, caused the Employer to discharge Otto A. Roth for the purpose of encouraging membership in the Association and because he complained about and demanded the return of the aforesaid deductions from his wages.

7. On or about March 23, 1955, the Employer discriminated in regard to the terms and conditions of employment of Otto A. Roth for the purpose of encouraging membership in the Association by deducting from Otto A. Roth's wages an initiation fee and dues for the Association against the will of said Otto A. Roth and although said Roth had been employed less than 30 days, and contrary to the rights guaranteed to Otto A. Roth in Section 7 of the Act.

8. On or about March 24, 1955, the Employer, through its agent, Walter Schmidt, and its agent, Henry Mello, discharged Otto A. Roth for the purpose of encouraging membership in the Associa-

tion and, more particularly, because said Otto A. Roth complained that an initiation fee and dues had been deducted by the Employer, at the demand of the Union, from his wages and against his will and although he had been employed less than 30 days and because he sought to exercise rights guaranteed to him by Section 7 of the Act.

9. The Employer, since on or about January 1952, has dominated and interfered with the formation and administration of the Association and has contributed financial and other support to the Association.

10. The Employer, since on or about February 27, 1954, to date, has dominated, assisted, contributed to the support of, and interfered with the administration of the Association.

11. By the acts set forth in paragraphs 5 and 6 above, the Association did engage in and is engaging in unfair labor practices within the meaning of Section 8 (b), subsection (1) (A) and subsection (2) of the Act.

12. By the acts set forth in paragraphs 7 and 8 above, the Employer has engaged in and is engaging in unfair labor practices within the meaning of Section 8 (a), subsections (1), (2) and (3) of the Act.

13. By the acts sets forth in paragraph 10 above, the Employer has engaged in and is engaging in unfair labor practices within the meaning of Section 8 (a), subsections (1) and (2) of the Act.

14. The activities of the Association set forth in

paragraphs 5 and 6 above, occurring in connection with the Employer's operations described in paragraph 1 above, have a close, intimate and substantial relation to trade, traffic and commerce among the several states of the United States and have led and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce.

15. The activities of the Employer set forth in paragraphs 7, 8 and 10 above, occurring in connection with the Employer's operations described in paragraph 1 above, have a close, intimate and substantial relation to trade, traffic and commerce among the several states of the United States and have led and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce.

16. The aforesaid acts of the Employer, as described above, constitute unfair labor practices within the meaning of Section 8 (a), subsections (1), (2) and (3), and Section 2, subsections (6) and (7) of the Act.

17. The aforesaid acts of the Association, as described above, constitute unfair labor practices within the meaning of Section 8 (b), subsections (1) (A) and (2), and Section 2, subsections (6) and (7) of the Act.

Wherefore, the General Counsel of the National Labor Relations Board, on behalf of the Board, by the Regional Director for the Twenty-First Region, on this 30th day of April 1956, issues this

Consolidated Complaint against the above-named Employer and Association, Respondents herein.

[Seal] /s/ HENRY W. BECKER,
Regional Director National Labor Relations Board,
Twenty-First Region.

[Title of Board and Cases Nos. 21-CA-2061, 21-CA-2203 and 21-CB-708.]

ORDER CONSOLIDATING CASES AND NOTICE OF HEARING

The General Counsel for the National Labor Relations Board having duly considered the matter and deeming it necessary in order to effectuate the purposes of the National Labor Relations Act, as amended, and to avoid unnecessary costs or delay,

Hereby Orders, pursuant to Section 102.33 (b) of the National Labor Relations Board Rules and Regulations, Series 6, as amended, that these cases be, and they hereby are, consolidated.

Please Take Notice that on the 28th day of May 1956, at 10:00 a.m., D.S.T., in Room 704, 111 West Seventh Street, Los Angeles, California, a hearing will be conducted before a duly designated Trial Examiner of the National Labor Relations Board on the allegations set forth in the Consolidated Complaint attached hereto, at which time and place you will have the right to appear in person, or otherwise, and give testimony. Copies of the Charges upon which the Consolidated Complaint is based are attached hereto.

You are further notified that, pursuant to Section 102.20 of the Board's Rules and Regulations, you shall file with the undersigned Regional Director, acting in this matter as agent of the National Labor Relations Board, an answer to the said Consolidated Complaint within ten (10) days from the service thereof and that unless you do so all of the allegations in the Consolidated Complaint shall be deemed to be admitted as true and may be so found by the Board.

In Witness Whereof, the General Counsel of the National Labor Relations Board, on behalf of the Board, has caused this Consolidated Complaint and Order Consolidating Cases and Notice of Hearing to be signed by the Regional Director for the Twenty-First Region on this 30th day of April, 1956.

[Seal] /s/ HENRY W. BECKER,
Regional Director National Labor Relations Board,
Twenty-First Region.

United States of America
National Labor Relations Board

CHARGE AGAINST LABOR ORGANIZATION
OR ITS AGENTS

* * * * *

Case No. 21-CC-234.

1. Labor Organization or Its Agents Against
Which Charge Is Brought:

Name: Meat and Provision Drivers Union Local
No. 626, International Brotherhood of Teamsters.

Address: 846 South Union Avenue, Los Angeles 17, California.

The above-named organization or its agents have engaged in and are engaging in unfair labor practices within the meaning of section (8b) subsections (4) (C) of the National Labor Relations Act, and these unfair labor practices are unfair labor practices affecting commerce within the meaning of the Act.

2. Basis of the Charge:

On or about June 11, 1956, the party against whom the Charge is brought established a picket line at the place of business of Lewis Food Company, 817 East Eighteenth Street, Los Angeles, California; that on or about June 6, 1952, the NLRB certified the Association of Pet Food Manufacturers Employees as the bargaining representative of the employees of Lewis Food Company. Lewis Food Company has a collective bargaining agreement with the said Association; that at all times since June 11, 1956, the party against whom the Charge is brought has induced and encouraged employees of Lewis Food Company, Certified Grocers, Safeway Stores, Alfred M. Lewis Company and Wilson Trucking Company, to refuse to perform services for their respective employers, an object thereof being to force Lewis Food Company to recognize or bargain with Meat and Provision Drivers Union Local No. 626, as the representative of its employees, notwithstanding the fact that another labor organization has been certified as the representative of its employees.

3. Name of Employer: Lewis Food Company.
4. Location of Plant Involved: 817 East Eighteenth Street, Los Angeles, California.
5. Type of Establishment: Factory.
6. Identify Principal Product or Service: Manufacturing and Distributing Pet Foods.
7. Number of Workers Employed: 175.
8. Full Name of Party Filing Charge: Lewis Food Company.
9. Address of Party Filing Charge: 817 East Eighteenth Street, Los Angeles, California.
10. Telephone Number: Madison 6-0581.
11. Declaration:

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

LEWIS FOOD COMPANY,
By RAY L. JOHNSON, JR.,
Attorney for Lewis Food
Company.

June 14, 1956.

NATIONAL LABOR RELATIONS BOARD

Twenty-First Region

111 West 7th Street, Los Angeles 14, California

Lewis Food Company October 15, 1956
817 East Eighteenth Street
Los Angeles, California

Re: Meat and Provision Drivers Union Local No.
626, International Brotherhood of Teamsters
(Lewis Food Company) Case No. 21-CC-234

Gentlemen:

The above-captioned case charging a violation under Section 8 of the National Labor Relations Act, as amended, has been carefully investigated and considered.

As a result of the investigation, it does not appear that there is sufficient evidence of violations to warrant further proceedings at this time and I am, therefore, refusing to issue Complaint in this matter.

Pursuant to the National Labor Relations Board Rules and Regulations, you may obtain a review of this action by filing a request for such review with the General Counsel of the National Labor Relations Board, Washington 25, D. C., and a copy with me. This request must contain a complete statement setting forth the facts and reasons upon which it is based. The request should be filed within ten (10) days from the date of receipt of this letter, except that the General Counsel may, upon good cause shown, grant special permission for a longer period within which to file.

Very truly yours,

Henry W. Becker
Regional Director

Certified Mail. Return Receipt Requested.

cc: General Counsel, National Labor Relations Board, Washington 25, D. C. Meat and Provision Drivers Union, Local No. 626, International Brotherhood of Teamsters, 846 South Union Avenue, Los Angeles 17, California. Hill, Farrer & Burrill, Tenth Floor—411 West 5th

Street, Los Angeles 13, California. Attn.: Ray
L. Johnson, Jr., Esq. Stevenson & Hackler, 846
South Union Avenue, Los Angeles 17, California.

NATIONAL LABOR RELATIONS BOARD

Office of the General Counsel

Washington 25, D. C.

Ray L. Johnson, Jr., Esq. January 11, 1957
Hill, Farrer & Burrill
10th Floor, 411 West 5th Street
Los Angeles 13, California

Re: Meat & Provision Drivers Union Local No. 626,
Int'l Bro. of Teamsters (Lewis Food Company)
Case No. 21-CC-234

Dear Mr. Johnson:

Your appeal from the Regional Director's refusal to issue complaint in the above case, charging violations of Section 8 (b) (4) (C) of the National Labor Relations Act, has been duly considered by the General Counsel.

The General Counsel sustains the ruling of the Regional Director. Like the Regional Director, the General Counsel concludes that there is insufficient evidence of violations to warrant further proceedings.

Yours very truly,

/s/ THOMAS J. RYAN,

Thomas J. Ryan

Assistant General Counsel

For the General Counsel

Gentlemen:

The above-captioned case charging a violation under Section 8 of the National Labor Relations Act, as amended, has been carefully investigated and considered.

As a result of the investigation, it does not appear that there is sufficient evidence of violations to warrant further proceedings at this time and I am, therefore, refusing to issue Complaint in this matter.

Pursuant to the National Labor Relations Board Rules and Regulations, you may obtain a review of this action by filing a request for such review with the General Counsel of the National Labor Relations Board, Washington 25, D. C., and a copy with me. This request must contain a complete statement setting forth the facts and reasons upon which it is based. The request should be filed within ten (10) days from the date of receipt of this letter, except that the General Counsel may, upon good cause shown, grant special permission for a longer period within which to file.

Very truly yours,

Henry W. Becker
Regional Director

Certified Mail. Return Receipt Requested.

cc: General Counsel, National Labor Relations Board, Washington 25, D. C. Meat and Provision Drivers Union, Local No. 626, International Brotherhood of Teamsters, 846 South Union Avenue, Los Angeles 17, California. Hill, Farrer & Burrill, Tenth Floor—411 West 5th

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Thomas J. Ryan

Assistant General Counsel

For the General Counsel

(1) The district court erred in denying appellant's motion to abate the above entitled action until the proceedings before the National Labor Relations Board, numbered 21-CA-2061, 21-CA-2203, and 21-CB-708 are fully and finally adjudicated.

(2) The district court erred in ruling that damages are recoverable under Title 29, U.S.C., Section 187 (Taft-Hartley Act) for picketing against a Union which has been certified by the National Labor Relations Board when the action is commenced after the said Board has initiated a proceeding to revoke the certification in its inception.

(3) The district court erred in holding that a certification by the National Labor Relations Board is valid while it exists regardless of the fact that the said Board subsequently revokes the certification from the time of its inception, and regardless of the fact that the certification was originally obtained by means of withholding material information from the National Labor Relations Board.

Dated: July 15, 1958.

STEVENSON & HACKLER,
/s/ By HERBERT M. ANSELL,
Attorneys for Defendants.

Proof of Service by Mail Attached.

[Endorsed]: Filed July 17, 1958.

In the United States District Court, Southern
District of California, Central Division

No. 20,333-Y

LEWIS FOOD COMPANY, a California corpora-
tion, Plaintiff,

vs.

LOS ANGELES MEAT & PROVISION DRIV-
ERS UNION LOCAL No. 626 OF THE
INTERNATIONAL BROTHERHOOD OF
TEAMSTERS, CHAUFFEURS, WARE-
HOUSEMEN AND HELPERS OF AMER-
ICA, etc., Defendant.

TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

February 17, 1958

2:00 P.M.

Honorable Leon R. Yankwich, Judge Presiding.

Appearances: For the Plaintiff: Hill, Farrer &
Burrill, By: Ray L. Johnson, Jr., 411 West 5th
Street, Los Angeles, California. For the Defendant:
Charles K. Hackler, 1616 West 9th Street, Los An-
geles, California. [1]*

The Clerk: Case 20,333-Y Civil, Lewis Food Com-
pany v. Los Angeles Meat Drivers Local 626, and
so forth.

* Page numbers appearing at top of page of Reporter's Tran-
script of Record.

Hearings on pretrial conference and setting, and defendant's motion for abatement.

The Court: We are back where we were before, gentlemen, a plea in abatemnt.

I will hear you further on the plea in abatement, gentlemen. I am familiar with the Juneau Spruce case. The only question is whether it applies to this situation.

Mr. Hackler: The court please, the facts alleged in the plea in abatement are not in dispute here. It is just a question whether under the law the plea in abatement states grounds for staying of this proceeding.

In the plea in abatement and also in our separate statement of material facts it appears that before the filing of this action that the National Labor Relations Board had issued a complaint, which is now outstanding, and begun hearings on unfair labor practice issues against the company and the so-called independent union.

One of the allegations of that complaint—and it is set out in full in our plea in abatement—is the allegation that that association was at all times after January 1952 an illegal company-dominated organization. The pleadings and [3] admitted facts show that after its formation in 1952 it participated in and won a Labor Board election back in the beginning sometime, maybe it was in 1952.

In any event, the incidents that give rise to this lawsuit began in 1954 with picketing of the company's premises, which is admitted. About the time the picketing began the union involved here, the

Meat and Provision Drivers Local Union, filed a charge with the NLRB complaining that the association was, in fact, a company-dominated organization, even though it was functioning as the bargaining agent, and claimed to have a certificate of bona fideness that it was the bargaining agent from the Board.

Now, for reasons known only to the Board, the Board sat on that charge of unfair labor practices. Under the federal law and under the Taft-Hartley law a charge initiates a formal investigation by the Board, but is not itself, of course, any more than like a complaint in a criminal action; it initiates action by an administrative body.

The Board did nothing with that charge until up in April of 1956, at which time, based upon that charge and also upon a later charge filed by an individual, it issued the complaint which is now the subject of Labor Board action.

A hearing was set up, a Trial Examiner came in from San Francisco. At the beginning of the hearing the Government's attorney, — of course, your Honor is familiar with the [4] fact that Labor Board attorneys themselves prosecute those cases in the name of the Government—asked for compliance with certain subpoenas for documents and appearance upon the part of company officials and officials of the attacked association. They declined to produce them and from that time until this, namely, April or June—I think the complaint was issued in April and it was to go to trial in June, or start the trial

—he recessed the hearing indefinitely to give the Government a chance to enforce those subpoenas.

Those subpoenas have been through the District Court here, through the United States Court of Appeals, and now certiorari has been granted by the Supreme Court on the narrow issue of whether or not the subpoenas were properly issued by the proper authority and within the scope of the administrative agency.

Following the issuance of that complaint the union resumed its picketing. It had actually picketed for three months back in 1954, August 19th until October 19th. No picketing took place between October 19, 1954, and shortly after the complaint was issued in 1956. Unfair labor practice charges were filed against the union on account of that picketing and dismissed by the Board as being without merit. And this suit was filed after the Board had issued its complaint attacking the bona fideness of the association from the beginning, attacking the company as having, according [5] to the complaint and what the Government is going to attempt to prove, that it sponsored, dominated and financed and assisted the organization from the beginning. They seek damages for both sets of picketing, the three months of picketing back in 1954 and the resumed picketing that began in 1956.

Now, it is conceded here that the basis of the damage action is a federal tort created by Section 303 (a) (3) of the Taft-Hartley Act. The tort created by that section is the calling of a strike or

similar activity by a union to oust a certified bargaining agent from its right as the exclusive representative of employees. That is all there is to the section. There are other sections that create damage actions for other types of conduct, but this one is premised, the gravamen of it is that the union I represent has been picketing in derogation of certified bargaining rights of another union. That section of the law, your Honor, condemns primary picketing. It isn't the secondary boycotting section. It says that no union, once the Board has certified a bargaining agent, should seek to oust that bargaining agent by picketing, but, on the contrary, it should take other steps to displace it.

It should be pointed out that if that organization is not a bona fide certified organization there isn't any tort. The law was not made, Congress did not see fit to make it and [6] create a damage action. These are statutorily created torts, not common law torts. It did not see fit to create a tort damage liability for primary picketing of an employer, even though there might be two unions in the picture, unless one of them were certified by the Board.

Now, the Board is at present engaged in an administrative proceeding, an unfair labor practice proceeding, over which it, of course, has plenary authority to determine whether that organization that it certified way back in 1952, I guess it was, ever was a valid labor organization under the Act, or whether, in fact, it was formed, dominated and assisted in violation of the Act.

Necessarily included within that would be a determination as to whether the Board's earlier action, in certifying it as a bargaining agent in 1952, either stands now or was ever entitled to stand. That is not an unusual situation, that a union will go to the Labor Board, get itself certified in an election, and it may be months or years before anyone brings to the Board a question as to whether it ever was a bona fide organization. That happens every day, and I have cited one of the United States Supreme Court cases, the well-known Wallace case, in which the Board held an election, certified a labor organization and actually participated in a settlement of company-union charges and allowed the union to continue to function, certified it and then later changed [7] its mind and initiated another proceeding and had for its effect the purpose of destroying the very existence of the organization. And that is pretty much the situation we have here. We have a tort action in which the defense is raised, one of the defenses—and obviously it is a definitive, dispositive defense, if it is true, the defense is raised that the certified union that we are claimed to be picketing against and in derogation of whose rights it is claimed that the picketing took place is itself now being examined to see if it ever had a right to function under the federal law.

Now, I don't think there can be any doubt, your Honor, that there is exclusive jurisdiction—not concurrent—in the National Labor Relations Board to determine what labor organizations are entitled to function in interstate commerce in this country. It

seems to me obvious—and the cases are to the same effect—you can't have state, federal courts and the Labor Board saying or making independent determinations of the bona fideness of labor organizations. Certainly, the Labor Board is the exclusive authority to grant or take away its own certifications, its own administrative acts of certifying labor organizations following an election.

Way back, I think it was under the Wagner Act, your Honor had one of the earliest cases—I believe it was the Douglas Aircraft case—where they sought to have this court enter into the intricacies of a representation election being [8] conducted or attempted to be conducted by the Labor Board. The earliest decided case——

The Court: Northrop.

Mr. Hackler: Northrop, yes. You are right, your Honor.

The Court: I had occasion to pull it out the other day.

Mr. Hackler: Its distinction——

The Court: It was Northrop against Madden.

Mr. Hackler: Yes. One of the earliest cases, if not the earliest case in the United States District Court in the country. Of course, the purpose——

The Court: There the question involved was that an election was pending and they came before the court and asked me to intervene on the ground that they already had a company union and it would nullify the contract. I held, in the first place, they were anticipating the result of what they might do, and, secondly, so far as the National Labor Relations

Act stood at that time, it provided a complete system of review and that that question could be raised in case the Board should certify the matter. Now, that is still the rule.

Mr. Hackler: That is the rule.

The Court: Now, the question before us is what remains of this special right they have given, that Congress has given in an action for damages arising out of the same practices. [9]

Mr. Hackler: Yes, sir. Let me address myself to that. We are clear that the rule is the same as it was when you decided that case, namely, with respect to elections and certifications of unions and the determination of what unions are bona fide and which ones are not entitled to function. Those are exclusively the province of the National Labor Relations Board, with appropriate appellate remedies through the United States Court of Appeals and to the Supreme Court.

Now, Section 303, the section under consideration here, does not alter that rule in a case such as this. Let me see if I can backtrack just a little.

The Court: I wish you would read it to me.

Mr. Hackler: All right, sir. The section provides——

The Court: I have it here, but I didn't want to stop and read it. If you read it aloud it will be easier.

Mr. Hackler: All right.

"It shall be unlawful, for the purposes of this section only, in an industry or activity affecting commerce, for any labor organization to engage in,

or to induce or encourage the employees of any employer to engage in, a strike or a concerted refusal in the course of their employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities, or to perform any services, where an object thereof is——” [10]

and there follows, your Honor, four different illegal purposes, any one of which creates a cause of action for damages.

The first of them is secondary boycott, where the purpose is—you are picketing a neutral employer over here, causing him to quit doing business with the people with whom you had a dispute.

The Court: I got all these first. I remember I had the first one involved, the Edison strike.

Mr. Hackler: Yes. The section involved here, though, is the section which says:

“forcing or requiring any other employer to recognize or bargain with a labor organization as the representative of his employees unless such labor organization has been certified as the representative of such employees under the provisions of Section 9 of the Labor Relations Act;”

Now, that Section 9, your Honor, goes back to the sections of the Act that are confided to the Board and not to the courts. So that you have a federal tort premised upon a union doing something in derogation of an administrative act of the Board, namely, the issuance of a certification, a government stamp, so to speak, in an administrative proceeding.

Now, a further damage action is predicated—and

I can [11] make the distinction by showing you that—not involved here—the jurisdictional strike section, but not involved in this proceeding, but it was involved in Juneau Spruce, where the illegal objective is:

“forcing or requiring any employer to assign particular work to employees in a particular labor organization or in a particular trade, craft, or class rather than to employees in another labor organization or in another trade, craft, or class * * *”

Now, that was the tort involved in the Juneau Spruce case, and the Supreme Court said in that case,—it was argued by the defendant union that, “You can’t go through the trial of a damage action against us until the Labor Board has processed unfair labor practice charges, which themselves complain of the selfsame conduct.”

In other words, the Board was proceeding to seek a cease and desist order against the selfsame conduct that the plaintiffs were in court seeking damages for. The court properly said, “Those are two separate remedies for the same conduct. One of them is in the public interest, prosecuted by a public agency, to bring about future compliance with the law and public interest. The other is a private action to redress damages caused in a private way by the same unfair practice.”

The Court said, “The one is not *res judicata* of the other. For example, the Government might [12] prove or not prove its case, according to the quality of the evidence. The private parties may be able to prove or not prove its case.”

But involved there was the selfsame conduct, where it said, in effect, "Congress has reached this conduct—granted two sanctions against it, one to run to the private party,"—and we know many areas in the law where that is true other than the NLRB. The Wage Hour has many sanctions, private and public, both. That is all it stands for.

Then the lawyers for the union came back and said, "Yes, but there is a little administrative proceeding that the NLRB is going through over here preliminary to issuing its complaint, in which it is trying to determine whether the picketing organization actually is entitled to the exclusive assignment of work and under a section of the law that authorizes and directs the Board to conduct that preliminary proceeding, to determine whether there is probable cause to believe the law has been violated.

I don't like to cite only your Honor's own cases, but your Honor may recall Los Angeles Building & Construction Trades case, which you heard in this court, and I was counsel for the Government in it, where you had the first case again involving that very Section 10 (k).

It was argued there you couldn't grant an injunction against a jurisdictional strike, that is, a strike to compel the assignment of work to members of one union rather than [13] another until the Board had concluded preliminary hearings to determine whether there was probable cause to determine whether one or the other organization was entitled to the work.

You ruled that you had the authority. You granted

the injunction. It went through the Ninth Circuit and was sustained, and I think certiorari was sought, and perhaps granted to vacate, and the case became moot.

Now, that is exactly the same section you were proceeding under there as the Juneau Spruce situation. Basically, the Juneau Spruce case says, "There is no *res judicata*. There is no requirement that you get the Labor Board to find an unfair labor practice before you file your tort action over the selfsame conduct."

There are many reasons for that that you can see would exist. The Board for monetary or policy reasons might drop the case or it might not assess the evidence as strongly as a private litigant. But that certainly has no application to the peculiar type of tort claimed here.

The very center of the tort here is whether or not the conduct of the union is in derogation of an administrative act of the Board, namely, the certifying of a union. It is that very act of certifying the union that that agency is now in the process of re-examining, whether that union was ever entitled to that certification. [14]

Assume, your Honor, you went ahead and tried the lawsuit. There are other fact issues, and that a judgment of damages were awarded against the union defendant. It would have to be premised upon the activity of the union in derogation of a certification of bargaining rights issued by an administrative agency. In effect, it would be implementing the act of that agency in issuing that certification.

Yet the union paid the judgment. The Labor Board in its current proceedings, if it establishes what it says in its complaint it can establish, would not only void the certification but actually destroy the labor organization itself that supposedly had the certification. It would rule that it legally had no right to function and, in effect, it had accomplished a fraud upon the Board when it got itself certified.

Well, should the union in that posture go back to the employer and say, "Well, you must have damages" for picketing against a certified union? The gravamen of it is the certification.

In a sense this unfair labor practice implements the Board's proceedings in certifying them. They could say, "Well, we want our money back. It has now been determined by the Board that it never should have issued that certification. It was defrauded into issuing it. It didn't know at the time the labor organization was formed in violation of the law." As a part of a scheme of unfair labor practice I have cited [15] the cases to show the kind of remedy the Board issues if its complaint is sustained.

There can be no question as to the scope of that proceeding, because I have quoted the two paragraphs of the complaint which flatly say that the attack is upon the bona fideness from the beginning of that organization in its certification.

The Court: The question is this: The complaint merely shows what would appear to be the final action that has gone to the Court of Appeals, supplemented by an injunction to prevent picketing and

so forth. Isn't there a finality to the action of the Board—regardless of what they may do in the future, wouldn't any damages which resulted from the prior action which you are now seeking to relitigate, wouldn't there be a bar to reopen that? Otherwise, they would never know when this remedy by damages would apply.

Mr. Hackler: Well, let me get at it this way, your Honor, so we are clear on our facts: Going back to August of 1954 the union began its picketing and at the same time made a charge that the certified union was not entitled to its certification. That it, in fact, was unlawful. Concurrently those two acts took place.

The Board did nothing with the charge for two years. But in the meantime they prosecuted the union and obtained a Board order,—it never went to the courts—saying that, "This union does have a certification. You did picket against it. [16] You should cease and desist doing so in the future."

The Board complied with that order and never went to the United States Court of Appeals for enforcement.

In the meantime the Board took another look at the earlier proceedings long pending before it and said, "We now have found we are going to process the earlier charge, that it was a company union all the time." They are processing that at the moment.

After issuing that complaint the union reinstituted its picketing; its position had been vindicated.

Here the Board now is willing to go back to the beginning and in effect say, "We were in error in

processing this other case. We saw fit to process it first."

The union came into the other case and said, "We want to prove in the first case it is a company union."

The court said, "No, the only way you can do that is under unfair labor practice charges separately filed against these parties. You can't urge it defensively."

We said, "All right. We have got our charge on file. Maybe sooner or later you will proceed upon it," which they have done.

Subsequent to the issuance of the present complaint, which goes way back to the charge at the time of the picketing, the union renewed its picketing and the Board said, "Hands off. We are not going to issue another complaint nor are we [17] going to hold you in violation of our order, because we now see from the beginning this organization was improper."

If the Board had sustained in its present complaint, your Honor,—it is a simple motion to be filed in the earlier Board proceedings, to say, "Here, you have issued an order telling this union, 'Don't picket against this certified union because it has a valid certification. You have now said the certification never was any good. That they got it, in effect, by concealment and fraud because they were a company union from the outset.'"

A simple motion would vacate that proceeding, and as pointed out here in the Juneau case, there

isn't any *res judicata* so far as the unfair labor practices themselves are concerned.

Counsel has put into his complaint the fact that while the Labor Board ordered this union to cease and desist from its earlier picketing—I don't know where it has a place in this complaint because the Juneau case says that action is *res judicata*, any more than the court's action in a damage suit is *res judicata*. It isn't that that is *res judicata*. What it is is that the center of this particular unfair labor practice turns upon an administrative determination of the Board, as to whether there is a valid certification.

Now, let's go the other way. Suppose you do not abate the action. We defend here upon the ground this is a company [18] union, formed in violation of the law and not entitled to any certification. That it got it by fraud, and would prefer to come in and take considerable evidence, the same evidence the Labor Board is going to hear over here if they ever get through enforcing their subpoenas.

Now, your Honor is going to be asked to rule that you won't hear that evidence, and I think properly so. You would say, "Well, Mr. Hackler, we stand on the certification. I can't go behind it. I am not going to let you come over here and try to prove this was a company union from the beginning, in order to show that the certification that you allege was enacted in derogation should not have been issued. I cannot set the certification aside." You would tell me that, and properly so. So you would leave a litigant in this type of case where a

dispositive defense just isn't available to him at the time of the trial.

Now, conversely, suppose the Labor Board in its current proceedings isn't against the union, the defendant here, but it is against this plaintiff and its association. Let us suppose the Board fails to prove its case and solemnly declares, "This organization was legitimate from the beginning and its certification is still good," why, then I would be bound by that in your court, your Honor, when this action came on for trial.

In fairness to the court, I think there is only one forum. [19] The Board has said that in its first decision when I was trying to urge it defensively, when they were prosecuting us, they said, "No, Mr. Hackler, you must go through—get the General Counsel to issue a complaint, if you can, because he is the sole custodian." And I don't see any other answer.

I might say in passing, there are two lawsuits filed over in the state court over the selfsame picketing, filed before this action. They both are just sitting there. The same position is taken there.

Somewhere along the line, even under this authority, the union must be able to urge the defense effectively, that the certification it is supposed to be attacking was not valid in law, because the essential element in this case is that it was a certified union.

Now, the argument on the contrary runs like this: The certification is a piece of paper. It has the union's name on it and you can't go behind it. Once

that magic piece of paper came into the hands of a labor organization or a group alleging to be one, automatically damages grind if anyone pickets against it, ignoring the fact that the Board had issued it in an appropriate proceedings and is in the very act of tearing it up, if it is successful in its proceedings, and tearing it up *ab initio*.

The Court: When you say the company is damaged by a violation of an act permitted in derogation to them, don't [20] they have a right to institute an action and wouldn't the action be rather a usury suspended in the air?

Mr. Hackler: No, your Honor, because of this reason——

The Court: In the statute of limitations, for instance, we have what is known as a suspended provision. For instance, if a person is out of the state you couldn't be sued, the statute doesn't run during that period. That question is in the minority, is a minor question.

Mr. Hackler: I think the answer to that is this, your Honor: First, the employer can file its damage action the day the picketing began, when it has a union certification in the plant.

The Court: Didn't they do that here?

Mr. Hackler: They started——

The Court: They wanted to come here because they wanted me to start——

Mr. Hackler: What I was about to say, your Honor, was this: Suppose the action is filed, as it was here, there isn't any proceeding pending at the Board. I file a charge and the Board throws it out

for lack of merit. It is true it won't process the case against the certification. Then I am bound, I can't come in here and attack it, the certification. I am sure you are not going to hear evidence in the case.

You are going to say, "The certificate of the [21] administrative agency stands. I can't go behind it."

In the average case, where there is a bona fide organization, the plaintiffs filed—it can be filed either in the state court or the federal court, and there may not even be a charge of unfair labor practice because the issue may not even be in the case, but if it is in the case, I must then go to the court and if there is no merit to my matter they throw it out, and I am bound. It so happens that here they have found sufficient merit that they themselves are re-examining the bona fideness of this organization. It is true they are doing so after, on the strength of the certification they issued an earlier order against me.

I see the employer has this advantage, no one is saying to dismiss the action. You file an action, but if, while that action is pending, like this case I cited here, General American Tank Car Corporation. Now, there was an action for damages by a shipper, at a time when the ICC was inquiring into whether certain conduct amounted to an unlawful rebate. One of the defenses of the action against the shipper was, "I can't acknowledge these damages. If I did so it would be in the nature of an unlawful rebate."

And the court there said, "Whenever, in an action for damages, when the issues of a defensive char-

acter appear or are within the cognizance of an administrative nature, the proceeding ought to be stayed to get the word from the administrative [22] agency, after which the Board will be bound."

Now, that works in one of two ways. Suppose the Interstate Commerce Commission here simply dismissed the proceedings and said, "We don't think there is enough to proceed on here."

The Court: Oh, I agree with you on that. We had one case involving rates and we didn't discover it until the middle of the trial, the fact that the reasonableness of a charge had not been placed before the Board. We stopped the proceedings for ten months. It involved the shipping of furniture.

The question here is whether the company can deny the finality of that order, whether this action must stand by in the hope that some day the Labor Board might change its mind and decide it was an error, and the right of action accrues the moment there is such change. But it wouldn't entitle them to relief until such time as the Board said they were wrong; to all intents and purposes it was final.

Mr. Hackler: Well, I think, your Honor, it would be the same in the shipping case, if you said, "Well, we will go ahead and try it. The Federal District Court perhaps might grant damages and ignore the administrative proceedings, which might vacate those damages later."

I should point out equitywise, your Honor, the Labor Board started in June 1956, 19 months ago, that it sought to [23] go to trial. The trial has been

delayed, not by these defendants, but by the refusal to obey subpoenas that the United States Court of Appeals had said were valid subpoenas and ought to be obeyed. So actually the company here has successfully stalled the proceeding to determine whether this organization was ever bona fide. They are now the United States Supreme Court. Those delays are not caused by the union.

In the complaint they are seeking as best they can to bring to an issue and make a decision as to whether this was ever a valid organization. And for them to come to court, after the Board has attacked—they are not the employer who came in and said, “Oh, I filed my suit and then the union ran over to the Board and got the thing held up.” They filed their lawsuit after the Board had attacked the bona fideness of this organization. The picketing was not resumed until after the Board had issued its complaint.

The union in the strict belief, “Well now, here, the earlier three months of picketing the Board held was in derogation of the certificate of this other organization. Now at long last the Board has said it is going back to the beginning and erase this organization on picketing its protest over the very unfair labor practices alleged in the unfair Labor Board complaint.”

The Board declined to prosecute the union over [24] the second picketing. Charges were filed. They said, “There is nothing to them. We are not going to stultify our processes, now that we are proceeding on the theory this is an illegal organization, to

tie unions, up so they can't do anything about illegal organizations under the guise of a certificate which they obtained from us many years ago."

So if there is any feeling on the part of the Board the present picketing has been validated by them it is in support of their own position, where we have been delayed 18 long months here and we may be delayed much more, your Honor. The enforcement of the subpoenas is in the United States Supreme Court.

Let's assume they sustain the Ninth Circuit, or either way, the Labor Board starts again, resumes its hearings, it may be a year or 18 months with these kind of delaying tactics before you ever get a decision, not because of any delay of ours. The Government is prosecuting the union in this.

In the meantime we perhaps have been stuck for damages, as there are other issues, fact issues, but we stoutly insist we have as good authority as Judge Learned Hand on our side of the law, as to whether our picketing was against the certification. It is a live issue of fact here.

Supposing we go through a time-consuming and expensive trial here and your Honor should rule that issue against us, both on the law and the facts—which we hope wouldn't happen, but it is a possibility—and then we start an expensive appeal up to the Ninth Circuit. Why, this litigation will go on and on and on and on, where the ordinary orderly procedure, where a live issue exists, prosecuted by the federal agency who has sole authority to determine whether there is a bona fide certificate,

in the act of grinding out its processes, void the certificate, void even the existence of the organization.

Now, to say a damage action should be tried when all of those proceedings were in existence before it was even filed, it doesn't seem to me that is proper allocation of authority between courts and administrative agencies that gives the kind of practical results that people are entitled to.

I think that adequately states our position. I think the cited cases are——

The Court: I will hear from the other side.

Mr. Johnson: May it please the court, Mr. Hackler indicated that there might be some reason for our refusing to obey these subpoenas on the basis we want to delay these Board proceedings.

I want to state to your Honor if there wasn't merit in our position certiorari wouldn't have been granted by the United States Supreme Court.

We contend these subpoenas are wholly and entirely invalid. They seek to require the production of evidence we [26] are not entitled to produce. We won before Judge Thurmond Clarke here in the District Court, and I thought I had won in the Ninth Circuit Court. I was quite surprised when they upheld the validity of the subpoena.

I filed a petition for writ of certiorari in the Supreme Court and it was granted. Our petition is not for the purpose of delay, but they are seeking to require the production in evidence of documents that they are not entitled to see. And we are also testing the power of the Labor Board to permit Trial Examiners to rule on our petition to revoke,

when we contend the statute clearly indicates the Board itself should rule on these petitions. The action has merit and we think we ultimately will prevail, but that is a side issue.

Mr. Hackler in 50 minutes did not deal with the contentions that we make in this case, and that is that the Labor Board has already decided these issues in its administrative proceeding against the union.

When we filed charges against the union for violating Section 8 (b) (4) (C) of the Act, which prohibits picketing and boycotting to compel us to recognize another union, when we have a certified bargaining agent in the plant, the union sought to raise as a defense the same two defenses they have now raised in this proceeding. One, that the association hadn't complied with the statute insofar as the filing requirements were concerned, and, two, that from its inception [27] this association that was certified was a company-dominated organization. The Labor Board struck out those defenses.

If your Honor sustains their plea in abatement it means your Honor is going to rule contrary to the Labor Board, if you admit these are valid defenses, because the Labor Board has stated they are not. If I may, your Honor, I have a copy of the Board's decision here, and I want to read what the Labor Board said on this point:

"The General Counsel first moved to strike an affirmative defense alleged in the following language:

"That the Association was not and is not the

duly and lawfully certified bargaining agent of the Lewis employees, within the meaning of Section 8 (b)(4) of the Act, and that the certification issued to it on or about July 22, 1952, was not and is not a valid and enforceable certification within the meaning of the last-mentioned section of the Act for the following reasons:

"1. The Association was at the time of the Labor Board election and the time of its certification a company union within the meaning of Section 8(a)(2) of the Act and said fact was well known to the Board and its agents, at the time the election was conducted in these certification issues. [28]

"2. Said certification was fraudulently obtained by Lewis and the Association because they and each of them knew at the time of entering into the consent election agreement which gave rise to said certification, that the Association was a company union and could not therefore be a lawful bargaining agent for the Lewis employees.

"3. The holding of an election and the certification of the Association upon a consent election agreement was an abuse of the Board's election processes, and the certification arising therefrom may not therefore be affirmatively used to prevent lawful picketing by the Respondent." Being this defendant union.

"4. The representation proceedings from which the certification arose were not and are not valid as against this Respondent, for the reason that Respondent was not a party to such proceedings and did not therefore waive its right and privilege to

show the true facts concerning the Company's domination of the Association, and the Board was without authority under the Act to hold an election or issue a certification valid as against this Respondent, based upon the waiver [29] by another and different labor organization, of its rights to establish the company dominated character of the Association."

Those were the defenses, the same ones you have heard, the same ones that are in the pleadings and the ones you have heard this afternoon.

The Board goes on to say—let me preface this by saying this is the decision of the Trial Examiner and his ruling and reasoning was adopted by the Labor Board.

"The General Counsel moved to strike the allegations on the ground that the facts alleged did not constitute a valid defense to the allegations of the complaint. He argued that the affirmative defense alleged a violation of Section 8 (a) (2) of the Act, the interference or domination of a labor organization by an employer, which could be found only in an appropriate proceeding where a complaint alleging such a violation had been issued. He also pointed out that the defense alleged that the certification of the Association was issued by the Board on July 22, 1952, so that any acts of so-called company domination or interference committed by the Company prior to, or at any time close to the date of the certification would have been barred long since by the 6-months statute of limitations in the Act."

Counsel for the Company took the position that if the [30] association was a company-dominated union Local 626 had a right to file a charge against the employer and when the charge was established in an appropriate proceeding the Board could and would direct the employer to cease recognizing the association.

“As to the propriety of the defense, counsel for the Union argued that the Board is without any jurisdiction to issue a certification to the Association when the Board’s records afforded proof to the Board that the Association was a company-dominated union. He also argued that if a company could provide itself with a company-dominated union, which was able to obtain certification, that after 6 months no labor organization could picket that company without having a charge of 8 (b) (4) (C) placed against it. He stated he wished to introduce evidence to show that the Association was company-dominated, so that the Board could decide whether its administrative power could or should be used to promote and maintain a company-dominated union, or decide that the original certification should not have been issued.

“The motion to strike the affirmative defense was granted. The Trial Examiner stated that the certification of the Association had been issued by the Board in the course of a representation proceeding, [31] a type of proceeding over which it had exclusive jurisdiction, that the certification of the Association appeared to have been issued regularly and to be valid and proper on its face. He ruled

that under these circumstances the Union was restricted to legal procedure to set aside, vacate, or otherwise challenge the certification. He stated that, even if it were conceded that the action of the Board in certifying the Association was erroneous, an abuse of its discretion, or in excess of its authority, such a legal defect in the Board's determination and its certification, gave no right to the Union to decide for itself that the Board's determination was defective, and the Board's certification a nullity, and proceed to picket the Company, as if the certification and the certified representative did not exist. Fundamental legal procedure required that a decree or certificate of a judicial, or quasi-judicial tribunal, issued in a proceeding of which the tribunal had jurisdiction, which appeared valid and proper on its face be respected as valid until either the tribunal which had issued the decree or certificate, or higher authority, vacated, set aside, or rescinded the decree in an appropriate legal proceeding.

"The Trial Examiner pointed out that the Union [32] at any time could have filed a charge alleging Company domination or interference with the Association, and had the issue fully litigated before the Board and the courts, but that the Union could not arrogate to itself the right to decide that the Board's certification was null and void, and then picket the employer, as if the certified representative, and the certification, did not exist."

Now, as I have stated, the Labor Board adopted the ruling and the reasoning of the Trial Exam-

iner. Your Honor, that to me indicates that the Labor Board holds that its certificate is absolute until it is declared that we can no longer give effect to that certificate, and that it is no defense for a union to picket an employer with a certified union in the plant on the basis that the Board made an error in issuing the certificate or that the employer is dominating the association.

I do not understand yet and no one has been able to answer the question which I now ask. If the Labor Board ruled that this defense which they now present in this proceeding was no defense in the administrative proceeding, then we must either have a different body of law in the District Court than we do in the Labor Board proceeding or else we can proceed in this proceeding without regard to whether or not we have or it is found a year or two years from now that we have—— [33]

The Court: Their position is that the Labor Board had power to review its own decision, and that it has a proceeding before it now in which that question is, and until that is determined we shouldn't be determining the validity of their prior order.

Mr. Johnson: My point is this: The Labor Board has already determined that whether we have dominated that union does not constitute a defense and does not make lawful what the union has done.

The fact that the Labor Board may next year find we dominate this union has no retroactive effect. That certificate is good and valid on its face until the Board itself determines otherwise. And

it has said that the union cannot take it upon itself to decide that this certification is a nullity because they feel that we have dominated the union.

The Court: I am trying to clarify my own thoughts on the matter.

Mr. Johnson: Yes, your Honor.

The Court: Supposing they now, upon their own initiative, decide that the union was a company union from the very beginning. Wouldn't that, in effect, wipe out the act so that the violation by the union would in itself be a factor, because the court will declare that its prior order wasn't valid? [34]

Mr. Johnson: No, that isn't the effect of the Board's decision in this proceeding that it is taking against us. First of all, it will not determine that this certification was invalid from its inception. There is a six months statute of limitation in the Act. The certification was in 1952. They cannot rely on any of the acts in 1952 or at the time the union was certified, because 1954 was the date in which the picketing commenced. There is no power in the Board to make such a retroactive determination. The determination that the Board will make against us has nothing to do with the union—with the complaint against the union.

The Court: Intervening action.

Mr. Johnson: Yes. It will decide only from the time it issues its order we must cease recognizing that independent union. But, as Mr. Hackler said, the Board's action is one to guide future conduct. It doesn't have any retroactive effect. This union is still a certified union in this matter. We are still

giving effect to a contract on it. The Board only wins about 75 to 80 per cent of its own cases. Sometimes even though they prosecute and judge their own cases, the litigants sometimes win 20 to 25 per cent of the cases, but the significant thing is that even if they did ultimately decide we dominated this union it has no effect upon the validity of the union's conduct because the Board itself determined their certificate is valid and binding [35] against the union, until such time as they declare it to be invalid. And that the labor organization can't take it upon itself to start picketing where there is a certificate and then hope that the Labor Board will take action and that they can raise the defense that this is a company-dominated union.

We say, therefore, your Honor, going along with Mr. Hackler's thinking, there has been a determination by the administrative body in this case which is decisive of this point, namely, that their defenses which they now raise do not constitute a valid defense as to the legality of the union's conduct.

Let me point this out: I know, your Honor, that if it were ultimately found that we dominated this association, that if the union went back to the Labor Board and tried to get the Labor Board to modify or rescind their order and ruling, that they would certainly be unsuccessful in doing so, because the Labor Board has said in so many words that their certificate is absolute, until such time as they take action on the certificate.

In the meantime the parties can't take it upon

themselves to make a contrary determination. It has no retroactive effect.

Mr. Hackler keeps talking in terms of the fact that the Board is going to make some determination that since 1952 the certificate is invalid. I point out to your Honor this fact: [36] When we came in—I say “we”—when the Labor Board came in before Judge Peirson Hall for an injunction under Section 8 (a) (3) against the union, the defendants did not even raise this defense in that proceeding, namely, this defense that this was a company-dominated union.

The Labor Board stated in this proceeding which I am quoting from against the union, “The General Counsel’s representative stated to the Trial Examiner that they were going to dismiss the Teamsters’ charges against the company for lack of evidence.”

And that the only reason they didn’t do so is because there was no General Counsel. The General Counsel had resigned and the President hadn’t appointed a new General Counsel. If there had been a General Counsel in office, the statement of the General Counsel of the Board was that they were going to drop the charges which the Teamsters had filed against the company on the grounds they had no basis in fact or law.

Now, what happened? The Teamsters got a fortuitous break. In March of ’55, some six months later, the company engaged in conduct involving an employee, who was not even a member of their union, namely, they deducted his dues from his

paycheck before he had been with the company 31 days, and, as your Honor knows, an employee has 31 days in which to join the union. This employee was unhappy about it and he [37] went down and filed another charge against the company. It was on this new charge some six months later that the Board took action against the company.

As I state, in the proceedings against the union, the General Counsel made the statement they weren't going to proceed on the Teamsters' charge of company domination because there was no evidence of it, and they were just waiting for the appointment of a General Counsel to dismiss the action.

It was a fortuitous circumstance that six months later an employee went down and filed the charge against the company that this whole thing was opened up. It was something wholly unrelated to the offense involved, the picketing against the certification by the union. I wanted to clarify that point.

Your Honor, I have the transcript of the testimony if there is any question about it. I can certainly produce it, if there is any question about it, because I have it red-circled, the statement of the General Counsel representative on that point.

The Court: Well, I don't want to go behind the record. I am really concerned here with what appears on the face of the moving papers.

Mr. Johnson: I appreciate that fact, your Honor.

The Court: If the proceedings before the Counsel couldn't retroactively affect what happened in the

meantime, then no [38] matter what they do as to the future, then of course we are in the same situation.

As I gather, your argument is that that prior order, having become final, it is the law of the case and anything the union did in contravention of it is the subject of this tort action. If in the future in the present case they should decide that the union is company-dominated it would still not wipe out the prior order so as to legalize what had been done in the meantime.

Mr. Johnson: It is our position, your Honor——

The Court: Well, I am not doubting you——

Mr. Johnson: I understand. You are just thinking out loud.

The Court: I am just thinking out loud. Weren't you in the other day on that conference we had in the other matter, on the subpoenas?

Mr. Johnson: It was probably Mr. Gould.

The Court: We discussed some matters relating to some order pending now, where one company is trying to make me intervene and call for the enforcement of a subpoena the General Counsel doesn't want to enforce.

Mr. Johnson: Your Honor has before you, by way of exhibit, the Board's decision in the case against the union. And in the course of it they say, "In agreement with the Trial Examiner,——"

The Court: Isn't that attached to your complaint?

Mr. Johnson: Yes, your Honor. I just want to read about six or seven lines.

“In agreement with the Trial Examiner, we find that the strike and the ensuing picketing was for a proscribed object and that the respondent thereby violated Section 8(b)(4)(C) of the Act.”

That is the Act where they can't picket where there is a certified union in the plant.

“For the reasons set forth in the intermediate report,—” which I read to you, your Honor.

“—we also find that the Trial Examiner properly rejected the respondent's affirmative defenses that its conduct was not violative of Section 8(b)(4)(C) because the Association allegedly was illegally dominated at the time of its certification or because the Association allegedly was not in compliance with the provisions of Section 9(h) of the Act when it achieved certification.”

So you don't have before you, however, the reasoning which the Board adopted, and I would like—I have given your Honor the citation to the NLRB reports, which is 115 NLRB 890. I could give you the Labor Relations Manual citation on it, but I have the Intermediate Report here, and I state to your Honor that it is the Board's determination that [40] their certificate is absolute and that no union or employer could take it on himself to——

The Court: We don't have the Labor Board reports on the shelves of our library. If you want to leave that with the clerk we will return it to you later on.

Mr. Johnson: It is going to be one of my ex-

hibits, anyway, your Honor, so we could leave it in the file.

The Court: It may be received as an exhibit with this motion.

Mr. Johnson: I state to your Honor after reading this you will see that the Board takes the position its certificate is absolute and that no union or employer could justify ignoring that certificate.

Let me give you an analogy on the other side of the coin, your Honor. I, representing the employer, have a situation where there is a certified union in the plant—and this has happened and I have been prosecuted for it and it constituted no defense—there is a certified union in the plant, and within a month after the certification the employees on their own, without any action of the employer, want a different union and they present a petition to the employer and say, “We don’t want you to recognize that certified union. We don’t want it to represent us. Every one of these employees want this other union.”

So the employer, seeing the wishes of the [41] employees there on a petition, signed by every employee in the plant, ceases to recognize the certified union and recognizes this other organization. And we were found guilty of an illegal refusal to bargain with that certified union. They said that we couldn’t take it upon ourselves to make a determination as to whether that certification was valid or not. We had to bargain with that certified union until the Board told us otherwise.

Now, that certificate said the Board in that case

had validity at least for one year and we had to give it effect for at least one year.

Now, I say, on the other hand, that the union—and the Board has so ruled,—cannot take upon itself to assert that this union is company-dominated, therefore the certificate is void and therefore they are free to picket.

The Board said in the proceedings against the union, "This is a valid certification, issued pursuant to proceedings which the Labor Board has exclusive jurisdiction over. That certificate is valid until we or some court declares it to be invalid."

Now, I keep making this point. I will make it once again and then drop it. That determination has been made and it is the law of the case. Whatever decision they make against us, it will simply be a determination that we must cease recognizing the independent union. It will have no retroactive [42] effect whatsoever. It can't have any effect going back four years. The Board's decrees operate in the future. They take care of future conduct. Mr. Hackler made that statement himself in another connection. But that is the function of the Board, is to guide future conduct.

So, therefore, following Mr. Hackler's argument that the Labor Board must make the determination, I say they have made the determination in the proceeding against the union, which is dispositive of this issue, as to whether their defenses here are valid or not, and they have ruled that they are not. Their certificate is valid, even in the face of their defenses, and the defenses were stricken.

If your Honor should rule that their defenses are valid here and you have to wait until the Board gets through with its proceedings, it means your Honor must rule that these defenses are valid to this suit, which is a ruling which is contrary to the one made by the Labor Board in the proceedings against the union.

May I just have one second, to be sure I have covered the points I wanted to. There were a lot of subsidiary issues, your Honor, and I don't want to take your Honor's time on those. I am not even going to discuss the Juneau Spruce case, because I am firmly convinced that when your Honor reads the Board's decision in this case you will find they have ruled their certificate is valid until they or [43] some court revokes it. Until such time we must give effect to it and the union must give effect to it.

So we respectfully submit that nothing can be gained by abating this action until the Labor Board makes its determination against the company, unless your Honor is prepared to rule that the subsequent determination of the Board has a retroactive effect, such as to give validity to the union conduct at the time they picketed in 1954. And I say that the Board itself has determined that the findings they make in the case against us is no defense for what the union did, and they were found guilty of unfair labor practices and their defenses along this line were stricken.

I say, therefore, your Honor, that the plea in abatement should be denied on the ground that the

Board's decision against us ultimately will have no effect on the issues in this case.

The Court: All right.

Mr. Hackler: Just briefly, your Honor. I construe the Board's earlier unfair labor practice decision just exactly the opposite of counsel. You will read it in the intermediate report at the bottom of page 9. It is true that the Trial Examiner said we, the union, could not offer evidence of company unionism to attack the certification. He did so on the ground that was not an appropriate proceeding. The only way you could attack the certification was [44] to get the Board itself to file an appropriate proceeding to test it out, to reconsider it and do whatever it wanted to with it. That is clearly stated. It is a long quotation and your Honor may have missed it. I read at the bottom of page 9:—this is the Trial Examiner whose reasoning was adopted by the Board—

“The Trial Examiner pointed out that the union at any time could have filed charges alleging company domination or interference with the Association, and had the issue fully litigated before the Board and the courts, but that the union could not arrogate to itself the right to decide that the Board's certification was null and void and then picket the employer, * * *”

Now, at the time he was ruling, your Honor, the Labor Board—he was telling us, “You can't defend on this ground. You have to convince the General Counsel to take agency action to attack this certification.”

In the meantime that agency action had been begun after this decision. And to show you clearly it means something to the NLRB, we only picketed three months, between August and October 1954, and then there wasn't one scintilla of activity in this plant until the middle of 1956, and the resumed picketing didn't take place until the Labor Board sent out its own proceedings, examining and attacking this certification.

We picketed after they issued a complaint in April, the [45] hearing came on in June and a few days after the hearing opened we began picketing. Our signs say, "We are picketing in support of the NLRB complaint."

The cases are legion in this country, both under the Wagner and the Taft-Hartley Act, that picketing in protest over unfair labor practices is far from being a violation of the Act, but enjoys the highest protection of the Act. Our present picketing right now is for that purpose, and the NLRB had administratively determined that to be true, because they have refused to entertain any charges over the renewed picketing.

Now, they want damages in this court for the picketing that began after the Labor Board started its own proceedings to re-examine this certification. The very thing that the Trial Examiner said, that it was our proper place to go. We finally got there after his decision.

The Labor Board is recognizing that it is not going to stultify itself by having one proceeding going, attacking the certification and the validity of

a union, and yet have another one going over here saying, "Yes, but you have to honor the piece of paper that that union got from us." They won't go on it, but he is asking this court to.

Now, he raises this issue: He says, "Oh, Labor Board remedies are prospective, and, in any event, even if they found we owned this organization body and soul," and the [46] employer, in effect, got himself certified as the bargaining agent, that it will only act in the future. That simply isn't the law. The Wallace case in the United States Supreme Court, which is cited in our brief, involved this set of facts:

The Labor Board had company union charges before it. It settled those. It settled those charges and went to an election, held a Labor Board-sponsored election and certified the alleged company union, saying in effect at that time, "There is no impediment, no impediment whatever in certifying you as the bargaining agent of these employees," even in the face of the charges.

They settled them out, and said, "Well, we think this union might have been assisted somewhat, but it wasn't dominated and, in any event, it has purged itself. We will certify it." And certified it as a part of a Labor Board-sponsored written settlement agreement between all parties.

The Labor Board came along a few months later and issued a complaint against the organization, and it was urged, "You can't reach back and undo the certification. You can't reach back and undo your own settlement agreement." That is the exact

issue that went to the United States Supreme Court.

The Board said, "We reach back in the public interest and do whatever is necessary to remedy unfair labor practices. Congress has confined to us those remedies, and in this case [47] we are reaching back."

I could cite you cases all afternoon where the Board, upon a finding of company unionism, has ordered the company to pay back the dues to the working people who were compelled, as a part of the company union scheme, to pay dues into the organization way back beyond the six months statute of limitation. Now, if that isn't giving retroactive effect to an order, I don't know what it is.

The short answer to that is, as I have cited the case in my points and authorities, and I have the quotation there, "It is for the Board to determine what the remedy will be to expunge the effect of unfair labor practices."

One thing, and then I will sit down, and that is, the time of this is important. In April of 1956 the Board issued its complaint. Just as the Trial Examiner said, "That is your remedy, Mr. Union, if you think this organization is no good."

They issued their complaint in June. They started the trial. The picketing began with the sign saying, "Protesting the Board's unfair labor practices." And it was after all of that that this plaintiff filed this lawsuit.

You don't have a case of an employer who comes in and files a lawsuit and then the union hastens

over to the Labor Board and says, "We will tie this thing up in some administrative proceeding." At the very moment the lawsuit was filed [48] the agency was in the process, as it is still 18 months later, trying to undo the certification. And what stands between us in getting it done is being dragged through the courts on subpoena enforcement. I think whatever equities there may be, one way or the other, the employer can't complain if he waits until the administrative agency itself is re-examining the validity of the certificate before he files a lawsuit. He is not in very good position to say, "Well, my lawsuit has to be tried first. I won't give the agency a chance to rule on this matter, to see what its remedy is going to be, although I stood by and waited until the association came under attack before I decided to seek damages in this court."

The Court: All right, gentlemen.

Mr. Johnson: May I reply to that last point? It is pretty serious.

The Court: Are we going to go back and forth?

Mr. Johnson: No, but this is a point that was raised and now I want to clarify this implication that we waited to file suit here until after the Board proceeded against us. That is completely false. Let me tell your Honor what happened.

The Court: The action was filed August 17, 1957.

Mr. Johnson: Right. Your Honor, I had filed three days after the picketing started a suit in the state court, under [49] the State Jurisdictional Strikes Act. I filed that in August of 1954, three

days after the picketing started. Then your Honor, who is familiar with labor law, knows we got a line of United States Supreme Court decisions, which took away from the state courts a great area of jurisdiction. I had serious doubt then of my ability to remedy this conduct under the state law.

I decided, therefore, before the statute of limitations ran in the federal court that I should file this action to protect myself in the possibility they might rule that there was no jurisdiction in the state court and then I would be out of both courts. So lest there be any erroneous implications arise out of Mr. Hackler's remarks, I want to state that the reason we didn't file until '56 in the Federal District Court is that I had an action on file to recover damages for the same conduct in the state court during that time and it was only when I thought that I had lost my right to proceed in the state court that I felt it necessary to file an action over here in the federal court under the federal law.

Thank you very much.

The Court: Gentlemen, the matter will stand submitted. I will vacate the order relating to pretrial because future pretrials will depend upon the ruling in this case. If I abate it, of course, it will lie dormant until we see what [50] the Board does, and if I do not, then I will merely notify you, and I will give you a couple of weeks' notice and we will take it up again and see what we can decide on pretrial.

So I will set aside the order for pretrial set for

today and order the matter, the plea in abatement, submitted, and give you further notice depending upon the ruling I make on this.

Mr. Johnson: If it will be all right, your Honor, I have exhibits in the pretrial conference order. Shall I hold them until we receive——

The Court: What could we accomplish now with this hanging in the air?

Mr. Johnson: I don't think they would accomplish anything. Under the rules, within a certain period of time I am supposed to put them in evidence with the clerk.

The Court: We will suspend the limitations, the time, of that general order,——

Mr. Johnson: That is what concerned me.

The Court: ——until I rule on this and then we will start over again.

Mr. Johnson: Thank you. That is what concerned me.

The Court: I will dispose of this as soon as I can, gentlemen, but I seem to have drawn quite a large number of important questions today. I was on the bench until 1:00 o'clock this noon, having some very complicated questions of [51] copyright law and summary judgment submitted to me and I am finishing work on a patent case and also trying a condemnation case, so I have to find hours in between to dispose of these matters.

I can't promise you a ruling under a couple of weeks.

Mr. Hackler: Your Honor, I think it might be helpful and in the interest of a full record to give

you the Board's complaint and order of hearing, so you have the whole present outstanding complaint of the Board.

The Court: If you want to present that as your evidence.

Mr. Hackler: I would like to offer that in evidence as part of the plea in abatement.

The Court: All right.

(Whereupon, at 3:35 o'clock p.m., Monday, February 17, 1958, an adjournment was taken.)

CERTIFICATE

I, Virginia K. Wright, hereby certify that I am a duly appointed, qualified and acting official court reporter of the United States District Court for the Southern District of California.

I further certify that the foregoing is a true and correct transcript of the proceedings had in the above-entitled cause on the date or dates specified therein, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Los Angeles, California, this 8th day of July, 1958.

/s/ VIRGINIA K. WRIGHT,
Official Reporter. [53]

[Endorsed]: Filed July 9, 1958.

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the Supplemental transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled matter:

A. The foregoing pages numbered 1 to 6, inclusive, containing the original:

Defendants - Appellants' Statement under Rule 75(d) F.R.C.P.

Designation of Record on Appeal by Defendants-Appellants, filed June 11, 1958.

B. One volume of Reporter's Official Transcript of Proceedings had on February 17, 1958.

I further certify that my fee for preparing the foregoing record, amounting to \$1.20, has been paid by appellant.

Dated: July 10, 1958.

[Seal] JOHN A. CHILDRESS,

Clerk,

/s/ By WM. A. WHITE,

Deputy Clerk.

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the

United States Court of Appeals for the Ninth Circuit, in the above-entitled matter:

A. The foregoing pages numbered 1 to 4, inclusive, containing the original:

Designation of Record on Appeal by Defendants-Appellants, filed 7/17/58.

Defendants-Appellants' Statement under U. S. Court of Appeals Rule 17(6).

I further certify that my fee for preparing the foregoing record, amounting to \$1.20, has been paid by appellant.

Dated: July 18, 1958.

[Seal] JOHN A. CHILDRESS,

Clerk,

/s/ By WM. A. WHITE,

Deputy Clerk.

[Endorsed]: No. 16022. United States Court of Appeals for the Ninth Circuit. Los Angeles Meat and Provision Drivers Union Local No. 626 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, et al., Appellants, vs. Lewis Food Company, a corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: May 19, 1958.

Docketed: May 19, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16022

LOS ANGELES MEAT AND PROVISION
DRIVERS UNION, LOCAL No. 626, ETC.,
et al., Appellants,

vs.

LEWIS FOOD COMPANY, a California Corpora-
tion, Appellee.

AMENDED DESIGNATION OF RECORD ON
APPEAL BY DEFENDANTS-APPELLANTS

Pursuant to Rule 17(6) of the Rules of Civil Procedure, Los Angeles Meat and Provision Drivers Union Local No. 626, etc., et al., appellants in this appeal, hereby designate that the following portions of the record, proceedings and evidence shall be contained in the record on appeal in the above entitled action:

- (1) Complaint;
- (2) Answer to Complaint for Damages and Plea in Abatement;
- (3) Minute Order February 17, 1958;
- (4) Memorandum by Judge Leon R. Yankwich;
- (5) Notice of Appeal;
- (6) Designation of Record on Appeal under Rule 17(6);
- (7) Application for Order Extending Time to File and Docket Record on Appeal and Order thereon;

(8) Intermediate Report and Recommended Decision and Decision of National Labor Relations Board in Case No. 21-CC-190 which is reported fully in 115 NLRB No. 136 (March 22, 1956);

(9) Charge of Unfair Labor Practices filed by Charles Rico against Lewis Food Company, Case No. 21-CA-2061, dated August 27, 1954;

(10) Charge of Unfair Labor Practices filed by Otto A. Roth against Lewis Food Company, Case No. 21-CA-2203, dated March 29, 1955;

(11) Charge of Unfair Labor Practices filed by Otto A. Roth against the Association of Food Handlers, Case No. 21-CB-708, dated March 29, 1955;

(12) Consolidated Complaint of Henry W. Becker, Regional Director, National Labor Relations Board, Twenty-First Region in Case No. 21-CA-2061, 21-CA-2203, and 21-CB-708, dated April 30, 1956;

(13) Order of Henry W. Becker, Regional Director, National Labor Relations Board, Twenty-First Region, consolidating Case No. 21-CA-2061, 21-CA-2203, and 21-CB-708, dated April 30, 1956;

(14) Charge of Unfair Labor Practices filed by Lewis Food Company against Meat and Provision Drivers Union Local No. 626, Case No. 21-CC-234, dated June 14, 1956;

(15) Letter from Regional Director of National Labor Relations Board, Twenty-First Region, dated October 15, 1956, to Lewis Food Company, dismissing Case No. 21-CC-234;

(16) Letter from General Counsel of National Labor Relations Board dated January 11, 1957, to

Ray L. Johnson sustaining the dismissal of Case No. 21-CC-234;

(17) Reporter's Transcript of oral argument presented on February 17, 1958.

Dated: September 2, 1958.

STEVENSON & HACKLER,
By HERBERT M. ANSELL,
Attorneys for Defendants Los Angeles Meat & Provision Drivers Union, Local No. 626.

Proof of Service by Mail Attached.

[Endorsed]: Filed September 4, 1958. Paul P. O'Brien, Clerk.



No. 16022

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LOS ANGELES MEAT AND PROVISION DRIVERS UNION LOCAL
No. 626 OF THE INTERNATIONAL BROTHERHOOD
OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND
HELPERS OF AMERICA, *et al.*,

Appellants,

vs.

LEWIS FOOD COMPANY, a corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

STEVENSON & HOCKLER,

By HERBERT M. ANSELL,

1616 West Ninth Street,

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FILED

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No. 16022
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

LOS ANGELES MEAT AND PROVISION DRIVERS UNION LOCAL No. 626 OF THE INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, *et al.*,

Appellants,

vs.

LEWIS FOOD COMPANY, a corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

Opinion Below.

The memorandum opinion and order of the trial court from which this appeal is taken is set forth in the Transcript of Record, page 27, herein referred to as [Tr.].

Statutes Involved.

The relevant provision of the National Labor Relations Act (29 U. S. C. 141 *et seq.*) are set forth in the Appendix, pages 1 to 3.

Question Presented.

Where a suit is filed by an employer under Title 29 U. S. C. 187(3) to recover damages against a labor union for picketing in the face of a certification and this suit is

filed after the General Counsel commences proceedings before the National Labor Relations Board under §8(a)-(2) to revoke the certification from its inception, should the suit be abated until the issues in the Board proceeding are completely and finally adjudicated?

Statement of Facts.

The present action is brought pursuant to the Labor-Management Relations Act, 29 U. S. C. A. §303(a)(3) and (b). This section authorizes suits for damages against labor organizations which strike to obtain recognition from an employer whose employees are represented by another union which has been *certified* by the National Labor Relations Board.

This appeal is taken from an order of Honorable Leon R. Yankwich denying a motion by the defendants to abate the above entitled damage action until the National Labor Relations Board fully and finally adjudicates certain unfair labor practice cases pending against the plaintiff company and an organization known as Association of Pet Foods Manufacturers Employees. In these cases the Board has alleged that the Association of Pet Foods Manufacturers Employees, the certified union, is and has been from its inception interfered with, dominated and controlled by the plaintiff company and therefore is not and never has been a *bona fide* trade union within the meaning of §8(a)(2) of the Act. If the Board is successful in these cases, it can order that the certification of the said Association be revoked *ab initio* and that the Association be disestablished. The defendant union has urged that if the Board ultimately revokes the Association certification in the pending cases, the sole basis for the present court action will have disappeared.

The material facts of this controversy are not in dispute. Outside of specific references to the transcript of record, the facts are set forth in the memorandum opinion of the trial court. [Tr. pp. 27-40.]

The plaintiff, Lewis Food Company, is a California corporation and maintains its principal place of business at 817 E. Eighteenth Street, in Los Angeles, California. It is engaged in the business of manufacturing, producing, distributing and selling pet foods. Said plaintiff produces and ships goods and materials in excess of \$250,000.00 to the States of Oregon, Washington, Nevada, Arizona and the Territory of Hawaii. [Clk. Tr. pp. 4-5.] Said plaintiff will hereinafter be referred to as "Company."

Defendants Los Angeles Meat and Provision Drivers Union Local No. 626 is a labor organization which exists for the purpose of dealing with employers concerning grievances, labor disputes, wages, hours of employment and conditions of work. Said defendant will hereinafter be referred to as "Union."

The Association of Pet Foods Manufacturers Employees will hereinafter be referred to as the "Association."

Pursuant to an order of the National Labor Relations Board in Consolidated Case No. 21-RC-2358, 2405 an election was held among the employees at the Company on June 6, 1952. Appearing on the ballot was Local 563, Amalgamated Meat Cutters and Butchers Workmen of North America, AFL, and the Association. *The Union was not in any way involved in this proceeding.* The Association won the election and on July 22, 1952 was issued its Certificate of Representative pursuant to §9(a) of the Act. On September 11, 1952, the Company and the Association entered into a collective bargaining agree-

ment. (Intermediate Report and Recommended Decision pp. 3, 115 NLRB 136.)*

On or around August 5, 1954, the Union began enrolling as members the employees of the Company in the above described unit, and by August 17 had obtained authorization cards from a substantial number. During the period August 5-17, the Company discharged six employees. On August 17, 1954, Charles A. Potter, President of the Union, by letter to D. B. Lewis, President of the Company, advised that the Union represented a majority of the employees and requested negotiations to begin for a contract. On that same day, the Union instituted representation case 21-RC-3697 by the filing of a petition for certification with the Regional Office of the Board at Los Angeles. This petition was subsequently withdrawn. (Intermediate Report pp. 4-5.)

On August 19, 1954 up until October 19, 1954, the Union engaged in picketing. On *August 25, 1954* the Union filed charges of unfair labor practices in Case No. 21-CA-2061 alleging that the six men discharged before August 18, 1954 were discharged because of their activities on behalf of the Union. The charge further alleged that the Association was a company union within §8(a)(2). [Tr. p. 43.]

On December 17, 1954, the Board issued a complaint against the Union based upon an alleged violation of §8(b)(4)(C) of the Act. The hearings on this complaint were held on January 31, February 28, and March 8, 1955. At the hearings the general counsel was successful in having stricken an affirmative defense the substance of

*Hereinafter this document will be referred to as "Intermediate Report."

which was as follows: That the certification of the Association is invalid and unenforceable because: (1) the Association at and since the issuance of the certification was a company union within §8(a)(2) of the Act; (2) the certification was fraudulently obtained by the company and Association by withholding material facts; (3) the holding of the election and certification was an abuse of the Boards process; and (4) the representation proceeding from which the certification arose did not preclude the Union from showing the true status of the Association because it was not party to that proceeding. The Union counsel offered to prove that the Association was company dominated so that the Board could decide whether its administrative power could or should be used to promote and maintain a company dominated union, or decide that the original certification should not have been issued. The trial examiner sustained the motion to strike and rejected the Union counsel's offer of proof *on the ground that such evidence could not be urged defensively but had to be raised in an independent §8(a)(2) proceedings*. (Intermediate Report pp. 8-9.) At the time of the hearing, the petition and charges filed by the Union were pending before the Board and had not been acted upon. These rulings were affirmed by the Board in 115 N.L.R.B. No. 136. In that decision the Union was held to be in violation of §8(b)(4)(c).

On March 29, 1955, an employee of the company named Otto A. Roth filed a charge numbered 21-CA-2203 and 21-CB-708 against the Company and Association respectively alleging that the Association was a company union within the meaning of §8(a)(2) of the Act. [Tr. pp. 47-50.] On April 30, 1956 the Regional Director consolidated the two charges of Roth and the 1954 charge filed by the

Union into one complaint. The complaint alleged *inter alia*:

“9. The employer since on or about January, 1952, has dominated and interfered with the formation and administration of the Association and has contributed financial and other support to the Association.”

“10. The Employer since on or about February 27, 1954, to date, has dominated, assisted and contributed to the support of, and interfered with the administration of the Association.” [Tr. pp. 22, 51-57.]

On *June 11, 1956*, hearings on this consolidated complaint began before the Board Trial Examiner. On the first day of the hearing, a number of officials of the Company and Association refused to be sworn as witnesses or to produce documents in accordance with subpoenas which had earlier been served upon them at the request of the General Counsel and the Board. [Tr. pp. 22-24.] Because of this fact, Counsel for the Board requested and obtained an indefinite postponement of the resumption of the hearings before the Trial Examiner in order to give him an opportunity to apply for an order from the United States District Court compelling obedience to the subpoenas. On *June 29, 1956*, the District Court entered an order in Civil No. 20119-TC denying enforcement of the subpoenas. The order was reversed by this Court in 249 F. 2d 832, decided on *October 29, 1957*. On *June 9, 1958*, the United States Supreme Court upheld the ruling of this Court.*

On *June 11, 1956*, the Union resumed picketing in support of the Board's complaint. On *June 14, 1956* the

*357 U. S. 10.

Company filed charges numbered 21-CC-234 alleging that this picketing constituted a violation of §8(b)(4)(C) of the Act. [Tr. p. 57.] On October 14, 1956, the Regional Director dismissed these charges and this action was affirmed on January 11, 1957 by the General Counsel. [Tr. pp. 59-61.] The present damage action of the Company was filed on August 17, 1957, *over 15 months after the General Counsel issued its complaint against the Company and Association in an effort to revoke the certification previously issued.* It is undisputed that the Union did not engage in any picketing against the Company within the period October 19, 1954 to June 11, 1956.

ARGUMENT.

Appeal Is a Proper Means of Reviewing the Denial of a Motion to Abate.

The grounds for appeal are enumerated in 28 U. S. C. 1292. That section provides insofar as pertinent:

“The courts of appeal shall have jurisdiction of appeal from: (1) Interlocutory orders of the District Courts of the United States . . . or of the judges thereof, granting . . . *refusing* or dissolving injunctions . . .”

It has been clearly established that the denial of a motion to abate constitutes a refusal by a trial court to exercise its injunctive powers and is therefore appealable within the above cited section.

In *Griesa v. Mutual Life Ins. Co. of N. Y.*, 165 Fed. 48, 50 an insurance company sued to cancel a life insurance policy. The insured's estate sued in the same court to recover the cash value of the policy. The company moved for a stay until its action was adjudicated.

The executor of the estate appealed from the trial court's grant of the stay. The company challenged the appealability of the order and the Court of Appeals said:

“As the order or decree in question was made upon a hearing in equity and was interlocutory, the decisive question is, did it grant an injunction? To us, the answer does not seem doubtful. A court of equity possesses no power to stay proceedings in a court of law, save by granting an injunction against the litigant actors therein and this is so well recognized that in a court of equity, *a stay of proceedings in an action at law is sought or ordered, it is understood that it is this injunctive power that is invoked or exercised*, although the technical terms ‘restrain and enjoin’ be not used.” (Emphasis added.)

In *United Fur Workers v. Colonial Hardwood Flooring Co.*, 168 F. 2d 33, 35, a company filed an action for damages against the union under §§301 and 303 of the Labor Management Relations Act for an alleged strike in breach of contract and secondary boycott activities. The union moved for a stay of proceedings upon the ground that the contract upon which the suit was based provided for arbitration of the matters in question. The union appealed the district court's denial of this motion and the appellate court said:

“*The defendants have appealed from this order; and we think it clear that the denial of stay in such case is, in effect, the denial of an interlocutory injunction, from which immediate appeal lies to this court. Shanferoke Coal & Supply Corp. vs. Westchester Service Corp., 293 US 499; Enelow vs. The N. Y. Life Ins. Co., 293 US 379.*” (Emphasis added.)

See also: *Elliclson v. Met. Life Ins. Co.*, 317 U. S. 188, 87 L. Ed. 176, wherein it was held that an order of abatement is in effect the exercise of interlocutory injunctive power.

It is therefore clear that the denial of defendants motion to abate this action pending the conclusion of proceedings before the National Labor Relations Board in an appealable order within the meaning of 28 U. S. C. 1292(1).

Since the Bona Fides of the Association and the Validity of Its Certification Are Principal and Dispositive Issues in This Case, the Court, Under the Doctrine of Primary Jurisdiction, Should Stay Proceedings Until the National Labor Relations Board Has Authoritatively Ruled Upon Such Issues in Its Pending Proceedings.

By way of clarification Appellants concede at the outset that the right to bring suit under §303(a)(3) and (b) of the Federal Act is not ordinarily dependent upon a finding by the National Labor Relations Board that a violation of §8(b)(4)(C) of the Act has occurred. Thus the fact that the General Counsel affirmed a dismissal of the Company's charges based upon the present picketing admittedly does not preclude this action. On the other hand, however, the Company has conceded and the record [Tr. pp. 51-57] discloses that the Regional Director commenced proceedings against the Company and Association on April 30, 1956 by the filing of a complaint wherein it attacked the *bona fides* of the Association since a date prior to the issuance of its certification. It is equally undisputed that if the General Counsel ultimately prevails in this proceeding, the certification of the Association will be revoked *ipso facto* from the date of its issuance. Since the damage action

authorized by §303(a)(3) by its terms is *completely dependent upon there being another labor organization with a certification*, the outcome of the Board proceeding numbered 21-CA-2067, 2203 and 21-CB-708 if favorable to the General Counsel *will destroy the sole basis for the instant court action*. The Union therefore requests that the Court, under the doctrine of primary jurisdiction, stay this action until the issues in the above numbered Board proceedings are fully and finally adjudicated.

The trial court in its opinion denying the Union's motion apparently treated this case as controlled by the decision in *ILWU v. Juneau Spruce Corp.*, 342 U. S. 237, 243, 96 L. Ed. 275, 281. In that case an employer brought suit for damages in a United States District Court under §303(a)(4) and (b) (jurisdictional dispute) prior to securing a determination from the National Labor Relations Board that the activities constituted an unfair labor practice under §8(b)(4)(D) of the Act. The Court held that §303(a)(4) could be invoked as a means of redress by damages independently of any action the Board takes as to the same conduct. The Court said:

“Certainly there is nothing in the *language* of §303(a)(4) which makes its remedy dependent on any prior administrative determination that an unfair labor practice has been committed.” (Emphasis added.)

The trial court would interpret this decision as applied to the instant case in the following manner: The Company can obtain damages for peaceful picketing based solely upon the certification of the Association notwithstanding the fact that prior to its bringing of suit, the General Counsel attacked the validity of the certification from its inception and notwithstanding that the Board,

which is the only tribunal having jurisdiction to effect the certification, decides that (1) It erred in issuing the certification initially, and (2) The certification would not have been issued absent the withholding of material facts and fraudulent misrepresentation on the part of the Company and Association.

The substantial distinction between *Juneau Spruce* and the instant case is patent. The effect of *Juneau Spruce* was simply that a private party can sue for damages under §303(a)(4) without exhausting its administrative remedy before the Board. Presumably the Courts rational in the *Juneau Spruce* decision applies with equal validity to a suit filed under §303(a)(1) or (2) of the Act. However, a prerequisite to the successful maintenance of suit under §303(a)(3) and the sole basis thereof is the *existence of a certification*. If the Board in the presently pending proceedings grants the relief sought by the General Counsel and this ruling is affirmed on review, *then as a matter of law, the Association was never certified* and it will be ordered disestablished and disbanded. (*National Labor Relations Board v. Shed-Brown Mfg. Co.* (C. A. 7, 1954), 213 F. 2d 163; *National Labor Relations Board v. Standard Coil Products* (C. A. 1, 1955), 224 F. 2d 465.) If the evidence falls short of complete company domination, the Board may order the Company to cease and desist from giving effect to the certification and cease dealing with it as bargaining representative of employees. In any event, as the Supreme Court said in *National Labor Relations Board v. Link-Belt Co.*, 311 U. S. 584, 600 in sustaining a company union disestablishment order:

“The Board, not the Courts, determines under the statutory scheme how the effect of unfair labor practices may be expunged.” (Emphasis added.)

The Board is fully empowered under §10(a) to void the certification from its inception and to order the Association disbanded upon a finding of company domination based upon facts preceding as well as following the certification. (*National Labor Relations Board v. Giffillon Bros., Inc.* (C. A. 9), 148 F. 2d 990; *Wallace Corp. v. National Labor Relations Board*, 323 U. S. 248.)

It is therefore submitted that as the basis for the present action in the existence of a *certified* union, and since the *certification* was attached by the General Counsel prior to the bringing of this action, the doctrine of primary jurisdiction discussed herein requires the court to stay its hand pending the determination by the Federal agency of the issues which control this action.

The doctrine of primary jurisdiction has been stated as follows:

“Primary jurisdiction . . . applies where a claim is originally cognizable in the courts, and comes into play whenever *enforcement of the claim requires the resolution of issues which under a regulatory scheme, have been placed within the special competence of an administrative body*; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views.” (Emphasis added.)

United States v. Western Pac. R.R. Co., 352 U. S. 59, 63-64, 77 S. Ct. 161.

Similarly in *General American Tank Car Corp. v. Eldorado Terminal Co.*, 308 U. S. 422, 432, 84 L. Ed. 361, 367, the Supreme Court ordered a contract damage action between a shipper and a railroad stayed until the Interstate Commerce Commission could rule upon the question as to whether the contract sued upon provided

for an unlawful rebate under the Interstate Commerce Act. The Court's rationale is equally applicable to the present proceeding in which an essential issue is the validity of the Association certification and of its right to function as a labor organization:

"When it appeared in the course of the litigation that an administrative problem, committed to the Commissioner was involved the Court *should have stayed its hand* pending the Commission's determination of the lawfulness and reasonableness of the practices under the terms of the Act" (Emphasis added.)

A clear statement as to the basis of the doctrine is contained in *Administrative Law Treatise*, Vol. 3, Davis (1958). At page 5 therein, it is stated:

"The principal reason behind the doctrine is recognition of the need for *orderly and sensible coordination of the work of agencies and of courts*. Whether the agency happens to be expert or not, a court should not act upon subject matter that is peculiarly within the agency's specialized field without taking into account what the agency has to offer, for otherwise *parties who are subject to the agency's continuous regulation may become the victims of uncoordinated and conflicting requirements*." (Emphasis added.)

On page 6 therein, it is further stated:

". . . the choice that lies behind the doctrine is between judicial action taken without the benefit of what the agency has to offer to the particular problem, and judicial action that fully takes into account the administrative position on the particular problem."

The close interrelationship between court and agency in effectuating a statutory scheme is emphasized in *Far East Conference v. United States*, 342 U. S. 570, 574, 72 S. Ct. 492, 494. In holding that an antitrust action was subject to abatement in deference to the Federal Maritime Board, the court said:

“ . . . court and agency are not to be regarded as wholly independent and unrelated instrumentalities of justice, each acting in the performance of its prescribed statutory duty without regard to the appropriate function of the others in securing the plainly indicated objects of the statute. *Court and agency are the means adopted to attain the prescribed end*, and so far as their duties are defined by the words of the statute, *those words should be construed so as to attain that end through coordinated action.*” (Emphasis added.)

The courts have consistently ordered actions abated whenever an issue arises within the peculiar competence of the administrative agency. In *McLean Trucking Co. v. U. S.*, 321 U. S. 67, 64 S. Ct. 370, a private action was brought under §7 of the Sherman Antitrust Act, 26 Stat. 209, 15 U. S. C. A. §7 to enjoin the consolidation of certain motor carriers. The Court held that *despite the Act's provisions for private suit (as with §303)*, the Interstate Commerce Commission should make a determination as to the effect of the consolidation on the over all transportation policy.

It seems clear that regardless of whether the ultimate relief sought is within the agency's power to grant, if some aspect of the court action involves the exercise of

administrative expertise, the agency should make its determination before the court assesses its legal significance. Since the question of *bona fides* of the Association arose prior to the commencement of this action and since the Board has exclusive power to order the Association disbanded and the *certification revoked*, the District Court should not undertake to assess damages against the Union based upon the *certification* until the Board has completed its determination. As stated in Administrative Law Treatise (*supra*) at page 27:

“A court should not act without the agency’s specific regulatory policy with respect to the particular problem in the particular circumstances.”

Again at page 39 therein, it is stated:

“The test is not whether some parts of the case are within the exclusive jurisdiction of the courts; the test is whether some parts of the case are within the exclusive jurisdiction of the agency. Because of the purpose of the doctrine—to assure that the agency will not be by-passed on what is especially committed to it—and because resort to the courts is still open after the agency has acted, the doctrine applies even if the agency has no jurisdiction to grant the relief sought.” (Emphasis added.)

Thus in *Thompson v. Tex Mexican Ry.*, 328 U. S. 134, 66 S. Ct. 937, a damage action was abated in deference to the Interstate Commerce Commission even though that agency lacked jurisdiction to award damages.

See also:

General American Tank Car Corp. v. El Dorado Terminal Co., 308 U. S. 422, 60 S. Ct. 325 (Stay of court to await I. C. C. determination of fact issue even though relief sought not available before commission);

Nathanson v. NLRB, 344 U. S. 25, 97 L. Ed. 23 30 (Stay by Bankruptcy Court to await NLRB determination of fact issue);

Order of Railway Conductors v. Pitney, 326 U. S. 561, 66 S. Ct. 322 (Stay by District Court to await ruling by National Railway Adjustment Board on jurisdictional dispute even though Board cannot make compulsory rulings).

It is submitted that the doctrine consistently applied in analogous situation compels a stay of the instant damage action until the Board has determined whether as a matter of law, the certification ever had any validity.

Denial of the Union's Motion to Abate May Result in Permitting the Company and Association to Profit From a Certification Which Was Obtained Through the Perpetration of Fraud Upon the Company's Employees, the NLRB and the General Public.

It is undisputed that the General Counsel has in his complaint attached the *bona fides* of the Association from a period *prior* to the issuance of the certification. [Tr. p. 54.] It is equally undisputed that the Union attached the *bona fides* of the Association as far back as *August 25, 1954* and that the Regional Counsel did not process this charge until *April 30, 1956*. Again it is undisputed that the Board hearing commenced on June 11, 1956 and were interrupted *for the sole reason* that the Company

challenged the legality of Board subpoenas and that this issue was not resolved until *June 9, 1958* when the United States Supreme Court upheld their validity.

Although this precise factual situation has not presented itself in any reported decision, the equities compel an abatement of this action. If the General Counsel establishes his case, then the Association will be adjudicated to be in violation of §8(a)(3) from the outset and the certification wrongfully issued. Apparently in directing his attack prior to the certification, the General Counsel believes that *if evidence he now has was disclosed originally by the Company and Association, the latter would never have been certified*. If the government is successful in the Board proceeding, then the effect is as follows:

By concealing evidence of company domination, a certification of the Association was obtained; the employees were deprived of their rights to be represented by a *bona fide* labor organization under §7; the Company by conduct which would have subjected them to prosecution under §8(a)(3) was able to install a certified Association and thus frustrate lawful organization and realistic collective bargaining by *bona fide* trade unions; furthermore the Company by the use of the certification obtained wrongfully from the Federal government was able to convert otherwise lawful economic activities to unlawful and recover damages therefor.

The House Committee in discussing the Federal Statute reported (H.R. Rep. No. 1147, June 10, 1935, 74th Congress, 1st Sess.):

“Collective bargaining is reduced to a sham when the employer sits on both sides of the table by supporting a particular organization with which he deals . . .”

The United States Court of Appeals in *National Labor Relations Board v. Griswold Mfgr. Co.*, 106 F. 2d 713 (3rd Cir.), stated the purpose and intent of the prohibition of §8(a)(2) as follows:

“It is the intention of our labor legislation that labor organizations shall be truly representative of the employee’s interests, and the *language* of §8 of the National Labor Relations Act prohibiting domination or interference with any labor organization *must be broadly interpreted so as to cover any conduct on the part of an employer which is intended to bring into being an organization which he has reason to believe will be ‘friendly.’*” (Emphasis added.)

In further explaining the effect of the Federal prohibition on collective bargaining, it is stated in *American Enka Corp. v. NLRB*, 119 F. 2d 60:

“ . . . Collective bargaining becomes a delusion and a snare if the employer, either directly or indirectly, is allowed to sit on both sides of the bargaining table; and, with the great advantage that he holds as the master of pay and promotions, he will be on both sides of the table if he is allowed to take any part whatever in the choice of bargaining representatives by the employees.”

The effect of denial of the Union’s motion to abate would be to hold that the Company by the exercise of this wrongful and bad faith conduct and by its ability to conceal, until after securing the certification can convert protected lawful activities, *Mastro Plastics Corp. v. NLRB*, 350 U. S. 270, 100 L. Ed. 2d 309, into an actionable federal tort.

If the Action Is Not Abated the Union Will Be Exposed to Damages on the Sole Basis of the Certification, the Validity of Which It Has Never Been Permitted to Challenge.

It will be recalled that the Union filed a petition for election on *August 17, 1954* and charges of §8(a)(2) on *August 25, 1954* and that on December 17, 1954, the Board issued a complaint against the Union under §(8)(b)(4)(C). Hearings on this complaint were held on January 31, February 28, and March 8, 1955. The Union's charges had not been processed at the time of the §8(b)(4)(C) hearing. Yet in his *Intermediate report and Recommended Order, 115 NLRB No. 136*, the trial examiner in excluding all Union evidence as to lack of *bona fides* of the Association stated:

"The Trial Examiner pointed out that the Union at any time could have filed a charge alleging Company domination for interference with the Association, and had the issue fully litigated before the Board and the Courts."

The effect of these circumstances is as follows: Although having the Union's charge before it in *August, 1954*, the Regional Counsel did not issue a complaint until *April 30, 1956*. The Union furthermore was not permitted to offer evidence of lack of *bona fides* at the §8(b)(4)(C) hearing. Thus because of an exercise of administrative discretion, the Company and Association escaped prosecution until June 11, 1956, the start of the present Board hearings, and conversely the *Union was not permitted for a period of almost two years to offer*

evidence against the bona fides of the Association although it attempted to use every available forum so to do.* When the Board hearings on the consolidated complaint were delayed indefinitely *as a result of the Company's refusal to honor the government's subpoenas*, the Union again was denied a forum by which to present evidence against the validity of the Association and certification. Thus through a series of circumstances *beyond the control of the Union*, charges filed against the Company and Association attacking the *certification* as far back as August 25, 1954 have not been as yet concluded. Surely under these circumstances the Company cannot be heard to complain that this action, based solely upon a *certification*, be abated until the Board determines whether the *certification* should be revoked from its inception. If the motion to abate is not granted, the Union may, as in the words of Professor Davis, become “. . . the victim of uncoordinated and conflicting requirements.”

We recognize the principal argument in opposition to the Union's motion to-wit: Under the Union's theory, an employer will never be sure he is immunized from economic activities because of the possibility that the Board may subsequently revoke a certification. It is not necessary to reach this question under the facts of the instant case. The Union simply contends that where, as here, a Company commences suit under §303(a)(3) *after* the government through formal complaint alleges the Union in question was formed in violation of §(8)

*In this connection, it is noted that the Union could not have attacked the Association in any state or federal court proceeding since exclusive jurisdiction to remedy unfair labor practices is vested in the NLRB. (*Garner v. Teamsters*, 346 U. S. 485; *Guss v. Utah Labor Relations Board*, 352 U. S. 817; *Weber v. Anheuser-Busch*, 348 U. S. 468.)

(a)(2), the court action should abate until the Board determines whether under its §10(a) equity power, it is advisable to revoke the certification from its inception. By so ruling this court can prevent a guilty employer from utilizing the fruits of his own unfair labor practices to gain damages against a labor organization which engages in conduct long held to constitute protected activity under the Federal Act.

Respectfully submitted,

STEVENSON & HOCKLER,

By HERBERT M. ANSELL,
Attorneys for Appellants.





APPENDIX.

"*Sec. 303. (a)* It shall be unlawful, for the purposes of this section only, in an industry or activity affecting commerce, for any labor organization to engage in, or to induce or encourage the employees of any employer to engage in, a strike or a concerted refusal in the course of their employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services, where an object thereof is—

(1) forcing or requiring any employer or self-employed person to join any labor or employer organization or any employer or other person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person;

(2) forcing or requiring any other employer to recognize or bargain with a labor organization as the representative of his employees unless such labor organization has been certified as the representative of such employees under the provision of §9 of the National Labor Relations Act;

(3) forcing or requiring any employer to recognize or bargain with a particular labor organization as the representative of his employees if another labor organization has been certified as the representative of such employees under the provisions of §9 of the National Labor Relations Act;

(4) forcing or requiring any employer to assign particular work to employees in a particular labor organization or in a particular trade, craft, or class rather than to employees in another labor organization or in another

trade, craft, or class unless such employer is failing to conform to an order or certification of the National Labor Relations Board determining the bargaining representative for employees performing such work. Nothing contained in this subsection shall be construed to make unlawful a refusal by any person to enter upon the premises of any employer (other than his own employer), if the employees of such employer are engaged in a strike ratified or approved by a representative of such employees whom such employer is required to recognize under the National Labor Relations Act."

"Sec. 303(b). Whoever shall be injured in his business or property by reason or any violation of subsection (a) may sue therefor in any district court of the United States subject to the limitations and provisions of section 301 hereof without respect to the amount in controversy, or in any other court having jurisdiction of the parties, and shall recover the damages by him sustained and the cost of the suit."

"Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3)."

"Sec. 8(a). It shall be an unfair labor practice for an employer—" (2) to dominate or interfere with the formation or administration of any labor organization or contribute financial or other support to it: . . ."

“Sec. 10(a). The Board is empowered, as hereinafter provided, to prevent any person from engaging in any unfair labor practice (listed in §8) affecting commerce. This power shall not be affected by any other means of adjustment or prevention that has been or may be established by agreement, law, or otherwise . . .”



No. 16022

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LOS ANGELES MEAT AND PROVISION DRIVERS UNION LOCAL No. 626 OF THE INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, *et al.*,

Appellants,

vs.

LEWIS FOOD COMPANY, a corporation,

Appellee.

APPELLANTS' REPLY BRIEF.

STEVENSON & HACKLER,
By HERBERT M. ANSELL,
1616 West Ninth Street,
Los Angeles 15, California,
Attorneys for Appellants.

FILED

APR 15 1959

PAUL P. O'BRIEN, CLERK



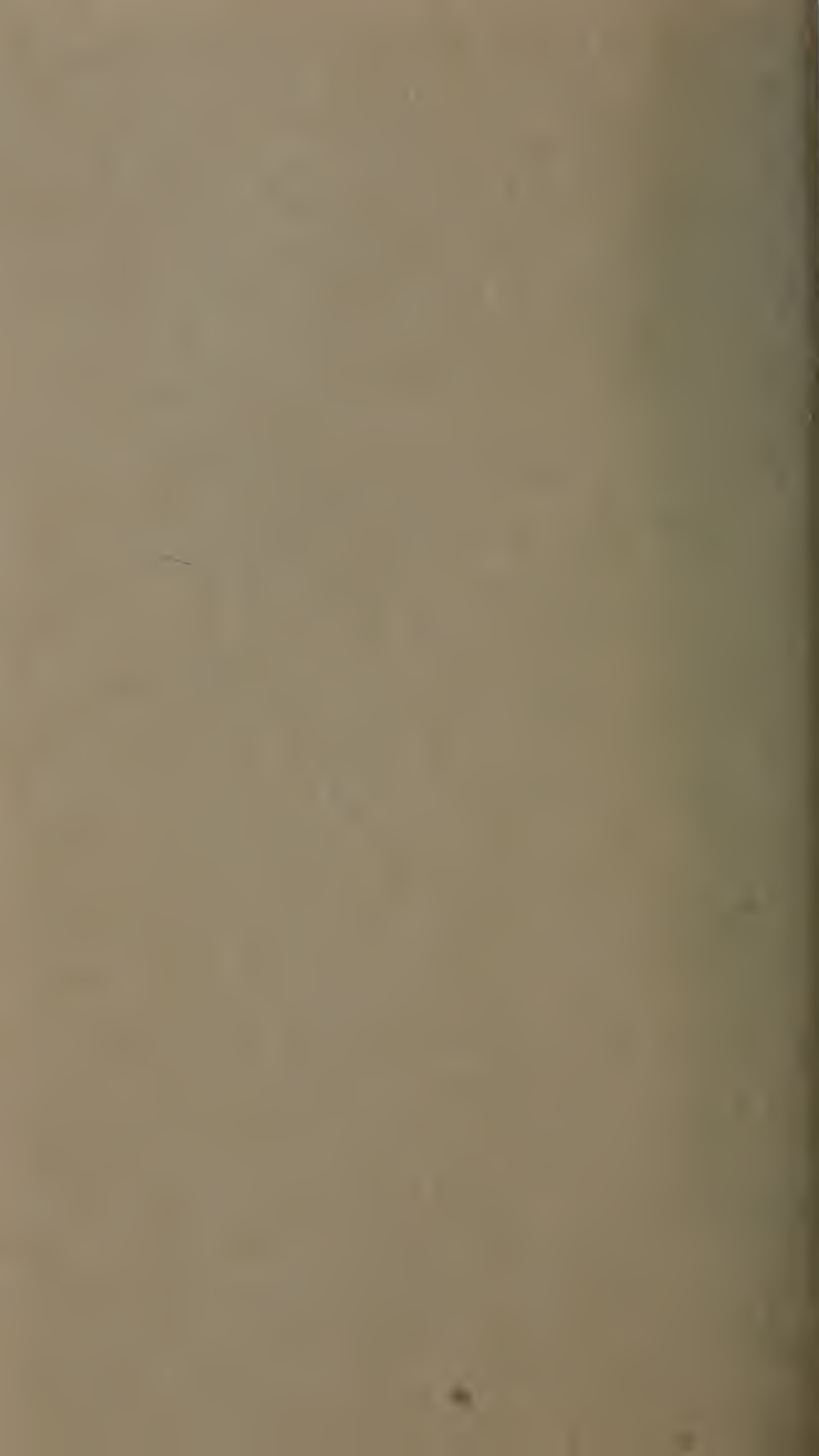


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Appellants,

vs.

LEWIS FOOD COMPANY, a corporation,

Appellee.

APPELLANTS' REPLY BRIEF.

Appellant Union desires to briefly respond to the contentions set forth in Respondent's brief.

Respondent contends that the National Labor Relations Board in 115 N. L. R. B. 890 has ruled that the lack of *bona fides* of the Lewis Employees Association does not constitute a defense to the §8(b)(4)(C) proceeding, the unfair labor practice counterpart to the instant case. We do not so construe that decision. The N.L.R.B. at the time of this decision, had not acted upon Case No. 21-CA-2061 (the Union unfair labor practice charge attacking the *bona fides* of the Association). The Board simply stated that the question of lack of *bona fides* of the Association could only be raised in an independent §8(a)(2) proceedings prosecuted by its General Counsel. Subsequently, a complaint was issued by him based on the

Union's charge and two other charges. This complaint specifically attacks the *bona fides* of the Association from its inception in 1952.

On June 11, 1956, the Union resumed picketing but despite the attempt of the Company to brand this activity as an §8(b)(4)(C) violation, *the general counsel now having taken the position that the Association was dominated and interfered with by the Company prior to and since it secured its certification, dismissed the Company's charges as to this picketing on merit.* [Tr. pp. 59-61.] This is true even though the *self same conduct* had been the basis of an §8(b)(4)(C) prosecution at a time *before* the General Counsel attacked the *bona fides* of the Association and its certification. Once having initiated a formal proceeding attacking the validity of the *Association from its inception*, the General Counsel has declined to proceed against the Union's resumption of picketing. In effect the Board's *present* position is that the Union's latest picketing is a protected protest over the Company's unfair labor practices.

As was stated in *Garner v. Teamsters*, 346 U. S. 485, 491:

"The Federal Board, if it should find a violation of the National Labor Management Relations Act, would issue a cease and desist order and perhaps obtain a temporary injunction to preserve the *status quo*. Or if it found no violation, it would dismiss the complaint, *thereby sanctioning the picketing.*" (Emphasis added.)

Therefore it is submitted that the General Counsel now is attacking the validity of the certification in the only manner possible, an §8(a)(2) proceeding, and, if successful, the sole basis of the instant case will have disappeared.

The Board by its treatment of the economic activity which commenced June 11, 1956 has impliedly declared that picketing in the face of a certification *which at the time is under attack by the Board*, is not violative of §8(b)(4)-(C). Therefore, good logic compels the conclusion that the damage action counterpart should be at least held in abeyance until final Board action on the certification is known.

This clear situation is not affected by the cases cited on pages 7-10 of Respondent's brief. Those decisions in substance establish that where certifications *are lawfully obtained in the first instance*, the employer owes a duty to respect them by bargaining with the certified union for one year even though the union is not active during that period and even though it has lost the support of the employees. The reason for this principle is that good faith bargaining requires a reasonable trial period. However, this is a far cry from the instant case wherein the *Company allegedly has dominated and interfered with the Association in its formation and operation from its inception, having brought it into existence for the purpose of forestalling legitimate collective bargaining.*

Respondent contends the Company must honor the *certification* and therefore the Union is under the same obligation. This is totally inaccurate. *The fact is the Company is being prosecuted by the General Counsel for the very reason that it is recognizing the Association as bargaining agent of the employees.* If the General Counsel is successful in his prosecution, the Company will be ordered to disestablish or at a very minimum cease all dealings with the Association. Finally, if tomorrow the Company were to attempt to purge itself of the government's charges, it would at the very least be required to stop dealing with

the Association, or in effect *disregard the certification, the very thing the Union is facing damages for.*

Apparently the Union will not be able to defend the damage action by direct evidentiary attack upon the validity of the *certification*, this subject being solely within the Board's provinces. If the Union is forced to trial now, it apparently will be foreclosed from offering any evidence to the effect that the Company and Association fraudulently secured the *certification* by concealing the Company union character of the latter. Assuming, therefore, that after a substantial damage award has been granted against the Union, the Board rules that the certification was invalid from its inception, and should never have been issued, the Union will be penalized merely because of the premature trial of the action. On the other hand, if the action is abated until the Board has completed its proceedings, the Court will be in a position to know whether the *certification*, the sole basis of the damage action, was lawfully in effect at the time of the picketing. The Company, in such event will have suffered no damages because of the delay.

It is finally noted that, as the matter stands at present, the Board is treating the Union's activities of August—September, 1954 as prohibited and the self same activities since June, 1956 as protected. Respondent has alleged that *all* of the activities are violative of §303(a)(3). Until the Board clarifies this confusing circumstance, the instant damage action should be abated.

Respectfully submitted,

STEVENSON & HACKLER,

By HERBERT M. ANSELL,

Attorneys for Appellants.

No. 16024 ✓

United States
Court of Appeals
for the Ninth Circuit

ADVANCE TRUCK COMPANY, a Corporation,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court
of the United States

FILED

AUG - 4 1958



No. 16024

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

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LEE A. JACKSON,
Attorney,
Department of Justice,
Washington 25, D. C.,
For the Respondent.



The Tax Court of the United States

Docket No. 59010

ADVANCE TRUCK COMPANY, a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A REDETERMINATION OF
INCOME AND EXCESS PROFITS DE-
FICIENCY AND FOR REFUND OF IN-
COME AND EXCESS PROFITS TAXES

Advance Truck Company, the petitioner, hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Internal Revenue Service symbols AP: LA:AA:DRR 90-D), dated May 11, 1955, and for a determination of refund of income taxes; and as a basis of its proceeding the petitioner alleges as follows:

I.

The petitioner is a corporation, duly organized and existing under the laws of the State of California, with its principal office at 21740 Alameda Street, Long Beach 10, California. The return for the period herein involved was filed with the Director of Internal Revenue for the Los Angeles, California, District.

II.

The notice of deficiency (a copy of which is attached, marked Exhibit A, and made a part hereof) was mailed to the petitioner on May 11, 1955.

III.

The deficiency as determined by the Commissioner is in income and excess profits tax for the taxable year ended December 31, 1950, in the amount of \$3,618.14 all of which is in dispute. In addition, the petitioner claims a refund of income and excess profits tax paid by it for the taxable year ended December 31, 1950, in the amount of \$5,348.06, or such other amount as the Court may determine.

IV.

The determination of tax set forth in the notice of deficiency is based upon the following errors:

(a) The respondent erred in determining that the petitioner was required to report its income on the accrual method of accounting for the taxable year ended December 31, 1950.

(b) The respondent erred in adding to petitioner's income for the taxable year ended December 31, 1950, accounts receivable as of December 31, 1950, in the amount of \$18,467.96.

(c) In the alternative, if the respondent correctly determined that the petitioner was required to report its income on the accrual method, the respondent erred in adding to petitioner's income for the taxable year ended December 31, 1950, accounts receivable as of December 31, 1949, in the amount of \$20,431.48.

(d) The respondent erred in not determining that the petitioner is entitled to a refund of income and excess profits taxes for the taxable year ended December 31, 1950, in the amount of at least \$5,-348.06.

V.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

1. The petitioner was incorporated under the laws of the State of California in 1923.

2. The petitioner is engaged in the business of hauling and storing tubular goods. It does not engage in manufacturing, processing, selling or purchasing merchandise. Its business does not require the use of inventories, and inventories are not an income producing factor.

3. From the date of its incorporation through and including the year 1949 the petitioner has kept its books of account and reported its income on the cash receipts and disbursements method of accounting.

4. In the year 1950 the petitioner was required by the Interstate Commerce Commission to keep its books of account according to the method prescribed by that regulatory body. This method requires the accrual of items of income and expense.

5. On or before March 15, 1951, the petitioner filed its income tax return for the taxable year ended 1950 in which it reported gross receipts from its operations in the amount of \$284,092.54. Included in

income to petitioner in the taxable year ended December 31, 1951.

Wherefore, the petitioner prays that the Court may hear this proceeding, and make the following determinations:

(a) That there are no deficiencies in the income and excess profits taxes of the petitioner for the taxable year ended December 31, 1950.

(b) That the petitioner overpaid its income for the taxable year ended December 31, 1950, in at least the amount of \$5,348.06.

(c) That the overpayment of taxes was paid by the petitioner within the periods prescribed in subsection 6512(b) (2) of the Internal Revenue Code of 1954.

(d) That the petitioner shall have such other and further relief in the premises as the Court may deem fit and proper.

Dated: July 27th, 1955.

/s/ JOHN B. MILLIKEN,

/s/ RALPH KOHLMEIER,

/s/ HARRISON HARKINS,

/s/ FRANK W. CLARK, JR.,

/s/ WALTER R. HILKER, JR.,

/s/ CHARLES H. CHASE.

Of Counsel:

/s/ L. A. LUCE.

Duly verified.

EXHIBIT A

U. S. Treasury Department
Internal Revenue Service
Regional Commissioner
1250 Subway Terminal Building
417 South Hill Street
Los Angeles 13, California

In Replying Refer to

Ap:LA:AA-DRR

90-D

May 11, 1955.

Advance Truck Company,
21740 Alameda Street,
Long Beach 10, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1950, discloses a deficiency of \$3,618.14, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia,

in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form, in duplicate, and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earliest.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner of Internal
Revenue;

By /s/ H. L. DUCKER,
Associate Chief, Appellate Division.

Enclosures:

Statement
Form 1276
Agreement Form
Exhibit A

Ap :LA :AA-DRR
90D

Statement

Advance Truck Company,
21740 Alameda Street,
Long Beach 10, California.

Tax Liability for the Taxable Year
Ended December 31, 1950

Income Tax

Year	Deficiency
1950	\$3,618.14

In making this determination of your income tax liability careful consideration has been given to the report of examination dated November 25, 1953, to your protest dated January 6, 1954, and to the statements made at the conferences held on March 20, 1954, and March 3, 1955.

During the year 1950 you changed, without obtaining the Commissioner's consent, the method of accounting in keeping your books from the cash basis to the accrual basis. Your corporation income tax return for the calendar year 1950 which was prepared and filed in accordance with the new basis of accounting (accrual) has been accepted.

Under the provisions of Section 41 of the Internal Revenue Code of 1939 a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. However, the courts have held the requirement of the Commissioner's approval of a change in accounting method is satisfied without express permission where the Commissioner accepts the return.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issue set forth in your claim for refund should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claim for refund will be disallowed and official notice will be issued by

registered mail in accordance with section 2773 of the Internal Revenue Code of 1939.

A copy of the letter and a copy of this statement have been mailed to your representative, Mr. Charles B. Lafferty, 650 South Spring Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

Adjustments to Net Income
Taxable Year Ended December 31, 1950

	Income Tax	Excess Profits Tax
Net income disclosed by return.....	\$78,014.16	\$75,996.41
Unallowable deductions and additional income:		
(a) Interest disallowed	600.00	600.00
(b) Franchise tax disallowed	2,975.20	2,975.20
Net income adjusted.....	\$81,589.36	\$79,571.61

Explanation of Adjustments

(a) In your return for the year 1950 you took a deduction of \$4,956.69 as interest expense, which amount included payments made to F. W. Appleton of \$600.00. It is held that these payments were in the nature of a preferential dividend and are disallowed as a deduction.

(b) The deduction you claimed for California franchise tax in the amount of \$6,284.76 includes the tax for doing business in 1950, based on 1949 income, and also the tax for doing business in 1951, based on 1950 income. It is held that the tax for doing business in 1951 is not an allowable deduction in the year 1950 and is disallowed in the amount of \$2,975.20.

Excess Profits Credit Based on Income
Taxable Year Ended December 31, 1950

Excess profits credit as shown on return.....	\$63,157.45
Corrected excess profits credit per Exhibit A.....	52,737.38
Decrease	\$10,420.07

Income and Excess Profits Tax Computation
Taxable Year Ended December 31, 1950

Income Tax

Net income	\$81,589.36
Less: Dividends received credit	315.56
	<hr/>
Surtax net income	\$81,273.80
Combined normal tax and surtax:	
(42% of \$81,273.80 minus \$4,750.00).....	\$29,385.00

Alternative Tax

Net income	\$81,589.36
Less: Excess of net long-term capital gain over net short-term capital loss	1,646.50
	<hr/>
Ordinary net income	\$79,942.86
Less: Dividends received credit	315.56
	<hr/>
Surtax net income	\$79,627.30
Partial tax (42% of \$79,627.30 minus \$4,750.00).....	\$28,693.47
Plus: 25% of long-term capital gain.....	411.63
	<hr/>
Alternative tax	\$29,105.10

Excess Profits Tax

Excess profits net income.....	\$79,571.61
Less: Excess profits credit.....	52,737.38
	<hr/>
Adjusted excess profits net income	\$26,834.23
(a) 30% of \$26,834.23.....	\$ 8,050.27
(b) 62% of \$79,571.61.....	\$49,334.40
Less: Normal tax and sur- tax on \$79,571.61.....	28,670.08
	<hr/>
Line (a) or (b), whichever is less..	\$ 8,050.27

Excess profits tax (184/365 × \$8,050.27)		\$ 4,058.22
Income tax (alternative tax appli- cable)		29,105.10
		<hr/>
Total income and excess profits tax liability		\$33,163.32
Tax assessed:		
Original, account No. 4101582.....	\$27,603.51	
Amended return, account No. 8-410500	1,941.67	29,545.18
	<hr/>	<hr/>
Deficiency of income and ex- cess profits tax.....		\$ 3,618.14

Excess Profits Credit Based on Income
Taxable Year Ended December 31, 1950

General Average Method

Base Period Years	1946	1947	1948	1949
Excess profits net income per return.....	0	\$39,164.58	\$67,170.90	\$71,427.85
Less: Long-term capital gain	--	-----	-----	8,095.92
	<hr/>	<hr/>	<hr/>	<hr/>
Excess profits net income as corrected....	0	\$39,164.58	\$67,170.90	\$63,331.93
Number of months in base period	12	12	12	12
Number of months selected		12	12	12
Excess profits net in- come for 36 months....				\$169,667.41
Average base period net income (\$169,667.41 ÷ 3)				\$ 56,555.80

Growth Method

Date of commencement of business.....		1923
Total assets as of January 1, 1946, the first day of base period.....		\$268,783.20
	Total Payroll	Gross Receipts
(1) Last half of base period.....	\$310,216.77	\$679,521.45
(2) First half of base period.....	227,278.34	440,076.96
Percentage which line (1) is of line (2)	136%	154%
Excess profits net income for last 24 months of base period.....	130,502.83	
(3) One-half of \$130,502.83.....		65,251.42
(4) Excess profits net income for last 12 months in base period.....		63,331.93
(5) Weighted excess profits net in- come for first 6 months of 1950....	\$ 31,828.62	
(6) Excess profits net income for last 6 months of 1949.....	31,665.97	
(7) Total of line (5) and line (6)....		\$ 63,494.59
Average base period net income based on growth, highest of lines (3), (4), or (7)		65,251.42
(8) 85% of \$65,251.42.....		55,463.71
(9) 85% of general average of \$56,555.80		48,072.43
Line (8) or (9), whichever is greater		55,463.71
12% of net capital addition for tax- able year		0.00
Total		\$ 55,463.71
12% of net capital reduction for taxable year		2,726.33
Excess profits credit based on in- come		\$ 52,737.38

Weighted Excess Profits Net Income for First 6 Months of 1950

(a) Excess profits net income	\$ 79,571.61
(b) Percentage applicable	80
(c) Weighted excess profits net income, (a) \times (b)	63,657.29
(d) Monthly average	5,304.77
(e) Number of months between January 1 and June 30, 1950	6
(f) Weighted excess profits net income for first six months, line (d) multiplied by line (e).....	31,828.62

Taxable Year Capital Addition or Reduction

Borrowed Capital	1/1/50	12/31/50
J. H. Baxter Company Trust Deed..	\$ 50,054.18	\$ 38,678.18
Security Bank Trust Deed	19,686.07	16,395.73
Security Bank Note	52,050.00	0.00
Total	<u>\$121,790.25</u>	<u>\$ 55,073.91</u>
(1) Borrowed capital at beginning of first taxable year ending after June 30, 1950.....		\$121,790.25
(2) Average daily amount of borrowed capital for taxable year		91,507.15
Net capital reduction, 75% of excess of line (1) over line (2)		22,712.33
12% of \$22,712.33		2,726.33

Received and filed August 3, 1955, T.C.U.S.

Served August 4, 1955.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I, II.

Admits the allegations contained in paragraphs I and II of the petition.

III.

Admits that the deficiency as determined by the Commissioner is in income and excess profits tax for the taxable year ended December 31, 1950, in the amount of \$3,618.14 all of which is in dispute. Denies the remaining allegations contained in paragraph III of the petition.

IV.

Denies the allegations of error contained in paragraph IV of the petition, and all subparagraphs thereof.

V.

1. Admits the allegations contained in subparagraph 1 of paragraph V of the petition.

2. Admits that the petitioner is engaged in the business of hauling and storing. Denies the remaining allegations contained in subparagraph 2 of paragraph V of the petition.

3. 4. Admits the allegations contained in subparagraphs 3 and 4 of paragraph V of the petition.

5. Admits that on or before March 15, 1951, the petitioner filed its income tax return for the taxable year ended 1950 in which it reported gross receipts from its operations in the amount of \$284,092.54. Included in this amount was the sum of \$18,467.96

which represented accounts receivable at December 31, 1950. Admits that petitioner, in its return, reported cost of operations in the amount of \$140,-629.46 and included the amount of \$196.20 which represented accounts payable at December 31, 1950. Admits that the amount of income and excess profits tax shown to be due on the return was in the amount of \$27,603.57. Denies the remaining allegations contained in subparagraph 5 of paragraph V of the petition.

6. Admits that the petitioner filed an amended income tax return for the taxable year ended December 31, 1950, showing an additional amount of income and excess profits tax due. Denies the remaining allegations contained in subparagraph 6 of paragraph V of the petition.

7. Admits the allegations contained in subparagraph 7 of paragraph V of the petition.

8. Admits that on or about January 14, 1954, the petitioner filed an additional amended income tax return for the taxable year ended December 31, 1950, in which it reported gross receipts from its operations in the amount of \$265,624.58 and cost of operations in the amount of \$140,433.26. Admits that the total income and excess profits tax shown to be due by the petitioner in this amended return was in the amount of \$24,197.12. Denies the remaining allegations contained in subparagraph 8 of paragraph V of the petition.

9. Denies the allegations contained in subparagraph 9 of paragraph V of the petition.

10. Admits that the petitioner on or about January 14, 1954, filed a claim for refund of income and excess profits taxes for the taxable year 1950, in the amount of \$5,348.06. Denies the remaining allegations contained in subparagraph 10 of paragraph V of the petition.

11. For lack of sufficient information, denies the allegations contained in subparagraph 11 of paragraph V of the petition.

12, 13. Denies the allegations contained in subparagraphs 12 and 13 of paragraph V of the petition.

VI.

Denies generally and specifically each and every allegation contained in the petition, not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that this appeal be denied and that the respondent's determination be sustained.

/s/ JOHN POTTS BARNES, R.E.M.

Chief Counsel,

Internal Revenue Service.

Of Counsel:

MELVIN L. SEARS,

Regional Counsel;

E. C. CROUTER,

Assistant Regional Counsel;

R. E. MAIDEN, JR.,
Special Assistant to the
Regional Counsel;

MARK TOWNSEND,
Attorney, Internal Revenue
Service.

Filed: September 27, 1955, T.C.U.S.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by the parties to this proceeding, through their respective counsel of record, that the facts stated in, or incorporated into, this stipulation are true and may be found as facts by the Court.

1. The petitioner was incorporated in 1932 and is now a corporation duly organized and existing under the laws of the State of California, with its principal place of business at 21740 Alameda Street, Long Beach 10, California. During all of the years mentioned herein, the petitioner filed its tax returns on a calendar year basis with the Collector of Internal Revenue for the 6th District of California, Los Angeles, California, and his successor, the Director of Internal Revenue for the Los Angeles, California District.

2. The petitioner is a common carrier and is engaged in the business of hauling and storing

tubular goods for hire. It does not engage in manufacturing, processing, purchasing or selling merchandise. Its business does not require the use of inventories, and inventories are not an income producing factor. At no time mentioned herein has the petitioner changed its type of business operation.

3. From the date of its incorporation through December 31, 1949, it properly kept its books of account and properly reported its income for Federal income tax purposes on the cash receipts and disbursements method.

4. On January 16, 1950, the petitioner received a letter from the Interstate Commerce Commission informing the petitioner that it was classified as a Class 1 Motor Carrier. Said letter, a copy of which is attached hereto as Exhibit 1-A, further stated that effective as of January 1, 1950, the petitioner would be required to keep its accounts in conformity with the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

5. The system of accounting prescribed by the Interstate Commerce Commission is set forth in Uniform System of Accounts for Class I Common and Contract Motor Carriers of Property, Prescribed by the Interstate Commerce Commission in accordance with part II of the Interstate Commerce Act. Issue of 1948. United States Government Printing Office. Washington: 1948. Said document is hereby incorporated by reference and will hereinafter be referred to as "The Uniform System of Accounts."

6. Instruction 2 of the Uniform System of Accounts provides in part as follows:

“(a) All of the accounts prescribed in this system of accounts shall be kept when applicable and entries recorded by the double entry method. Each account in the general or subsidiary ledgers shall reflect the prescribed account number * * *”

Instruction 3 provides in part as follows:

“(a) Each carrier shall keep its books on a calendar year basis and for each month (or 4-week period—see note) all transactions applicable thereto, as nearly as can be ascertained (see instruction 9), including full accruals, shall be entered in the books of original entry (cash books, purchase journal, etc.), and posted to the general ledger.”

7. Section 222 (g) of the Interstate Commerce Act provides that willful failure or refusal to keep accounts and records in the form and manner prescribed by the Commission shall be a misdemeanor punishable by a fine of not more than \$5,000.00 for each offense.

8. In conformity with the directive of the Interstate Commerce Commission the petitioner, as of January 1, 1950, changed its method of accounting to the method prescribed in the Uniform System of Accounts by numbering its existing accounts as prescribed and adding balance sheet accounts which it had not previously used in its accounting. These additional accounts and their numbers were: 1120 Accounts Receivable; 1171 Prepaid Taxes and

Licenses; 2059 Accounts Payable; 2120 Taxes Accrued.

9. In accordance with the facts set forth in paragraphs 4, 5, 6, 7 and 8, petitioner has kept its books and records on an accrual basis commencing January 1, 1950, to the present time.

10. On or before March 15, 1951, the petitioner filed its income tax return for the calendar year 1950, in which it reported gross receipts from its operations in the amount of \$284,092.54. Included in this amount was income from services rendered in 1950 of \$18,467.96 which was represented by accounts receivable at December 31, 1950. Also included in gross receipts was the sum of \$20,431.48, which amount was collected during the month of January, 1950, for services rendered during the month of December, 1949. On the accrual method of accounting, these amounts would have represented accounts receivable at December 31, 1949.

The petitioner reported cost of operations in the amount of \$140,629.46, which sum included the amount of \$196.20 which represented accounts payable at December 31, 1950. The amount of income and excess profits tax shown to be due on the return was the sum of \$27,603.51.

11. The form 1120 for the calendar year 1950 was prepared by C. C. Carter, petitioner's secretary. Question 10 on said return was answered as follows: Is this return made on the basis of cash receipts and disbursements? Yes.

12. On or about July 2, 1951, the petitioner filed an amended income tax return for the calendar year 1950 showing an additional amount of income tax due. The total income and excess profits tax paid by the petitioner for the calendar year 1950 was in the amount of \$29,545.18.

13. The petitioner has not at any time filed an application requesting the permission of the respondent to change the method of keeping its books of account or manner of reporting its income from a cash receipts and disbursements method to an accrual method.

14. On or about January 14, 1954, the petitioner filed an additional amended income tax return for the calendar year 1950, in which it reported gross receipts from its operations in the amount of \$265,624.58 and cost of operations in the amount of \$140,433.26. These amounts would be the correct amounts received and disbursed by the petitioner during the calendar year 1950 on a cash basis. The total income and excess profits tax shown to be due by the petitioner in this amended return was in the amount of \$24,197.12.

15. In the preparation of the foregoing amended return the following adjustments were made: Income from services rendered in 1950 of \$18,467.96, which was represented by accounts receivable at December 31, 1950, was eliminated from gross receipts. Accounts payable in the amount of \$196.20 were eliminated from cost of operations. The deduction

for real estate taxes was decreased \$2,862.77. The deduction for Social Security and State Unemployment taxes was decreased \$423.46. The deduction for Franchise tax was decreased \$2,975.21. The deduction for interest was decreased \$600.00. The amounts of the decreases in real estate taxes and Social Security and State Unemployment taxes were the difference between the amounts deductible on a cash receipts and disbursements basis and the amounts deductible on an accrual basis. The decreases in Franchise taxes and interest were in the amounts determined as unallowable deductions by the respondent in his notice of deficiency dated May 11, 1955. These latter amounts are not properly deductible by the petitioner on either the cash or accrual method.

16. On or about January 14, 1954, the petitioner filed a claim for refund of income and excess profits taxes for the taxable year 1950 in the amount of \$5,348.06. The amount of the taxes which it is claimed was overpaid by petitioner as set forth in said claim for refund was paid within the period prescribed in subsection 6512 (b) (2) of the Internal Revenue Code of 1954.

17. On or before the due date thereof, petitioner filed its corporation income and excess profits tax returns for the calendar years 1951 and 1952. These returns were prepared on the accrual basis.

18. On January 14, 1954, the petitioner filed amended corporation income and excess profits tax returns for the years 1951 and 1952. These amended

returns were prepared on the cash basis. On January 14, 1954, the petitioner filed claims for refund of income taxes paid for the calendar years 1951 and 1952 on the grounds that its returns for said calendar years 1951 and 1952 were erroneously prepared on the accrual basis instead of the cash basis.

19. As shown on petitioner's income tax returns, the petitioner's net taxable income for the calendar year 1951 on the cash basis is \$3,336.73 less than on the accrual basis. As shown on petitioner's income tax returns, the petitioner's net taxable income for the calendar year 1952 on the cash basis is \$4,323.05 less than on the accrual basis.

20. The petitioner's income tax returns for the calendar years 1953, 1954, 1955 and 1956 were prepared on the cash basis. The determination of income for these returns on the cash basis was made from petitioner's books of account in the following manner. The accounts receivable, accounts payable, prepaid taxes and accrued payroll taxes at the end of a calendar year were eliminated in computing taxable income and the amounts accrued to these accounts at the beginning of the calendar year were included in computing taxable income. The State franchise tax accrued at the end of a calendar year was eliminated and the franchise tax paid during the calendar year was included. The accrued federal income tax on earnings for the calendar year was eliminated.

These adjustments are entered on the work papers of the accountant who prepares the petitioner's

yearly income tax return, but are not entered on petitioner's books of account.

21. Attached hereto as Exhibit 2-B, 3-C and 4-D are photostatic copies of petitioner's original and amended income tax and excess profits tax returns for the calendar year 1950.

June 12, 1957.

Respectfully submitted,

/s/ CHARLES H. CHASE,
Counsel for Petitioner.

/s/ NELSON P. ROSE, R.E.M.
Counsel for Respondent.

EXHIBIT 1-A

Interstate Commerce Commission
Bureau of Accounts
and Cost Finding
Washington 25

Jan. 16, 1950.

Advance Truck Company,
21740 Alameda Street,
Long Beach 10, Calif.

Gentlemen:

The records of this Bureau indicate that your gross revenues are sufficient to classify you as a Class I motor carrier as provided in Instruction 1

of the Uniform System of Accounts prescribed by the Commission's order of November 21, 1950.

You will be required to keep your accounts in conformity with the provisions of the Uniform System of Accounts (a copy of which is enclosed) effective as of January 1, 1950. Please refer to Instruction 3 of the Uniform System of Accounts, which contains a mandatory provision requiring Class I motor carriers to keep their books on a calendar year basis.

As a Class I motor carrier you will be required to file a quarterly report for the quarter ending March 31, 1950, and for each quarterly period thereafter, such reports are required to be filed in the district office of the Bureau of Motor Carriers at San Francisco, Calif., within 30 days after the end of the quarter.

You will also be required to file an annual report for the year 1950 and for each year thereafter; such reports are due to be filed in duplicate in Washington, D. C., by March 31 of the year following.

For your information, there are enclosed copies of orders of the Commission prescribing the filing of quarterly and annual reports, together with sample copies of report forms. A supply of report forms will be furnished you through our regular mailing channels in sufficient time for preparation and filing of reports when due.

Effective as of January 1, 1950, in addition to any other requirements for the reporting of hours

of service of drivers to which you have heretofore been subject, you will become subject to the requirement for filing reports on BMC-57 covering each calendar month during which no driver exceeds the on duty or driving time permitted by Rule 191.3 of Part 5 of the Motor Carrier Safety Regulations. Such report must be prepared in triplicate and filed in duplicate in the office of the district director not later than the 15th day of the month next following that for which report is made. Triplicate copy must be retained in your files.

Please acknowledge receipt and understanding of this letter and if any further information is desired, do not hesitate to communicate with this Bureau.

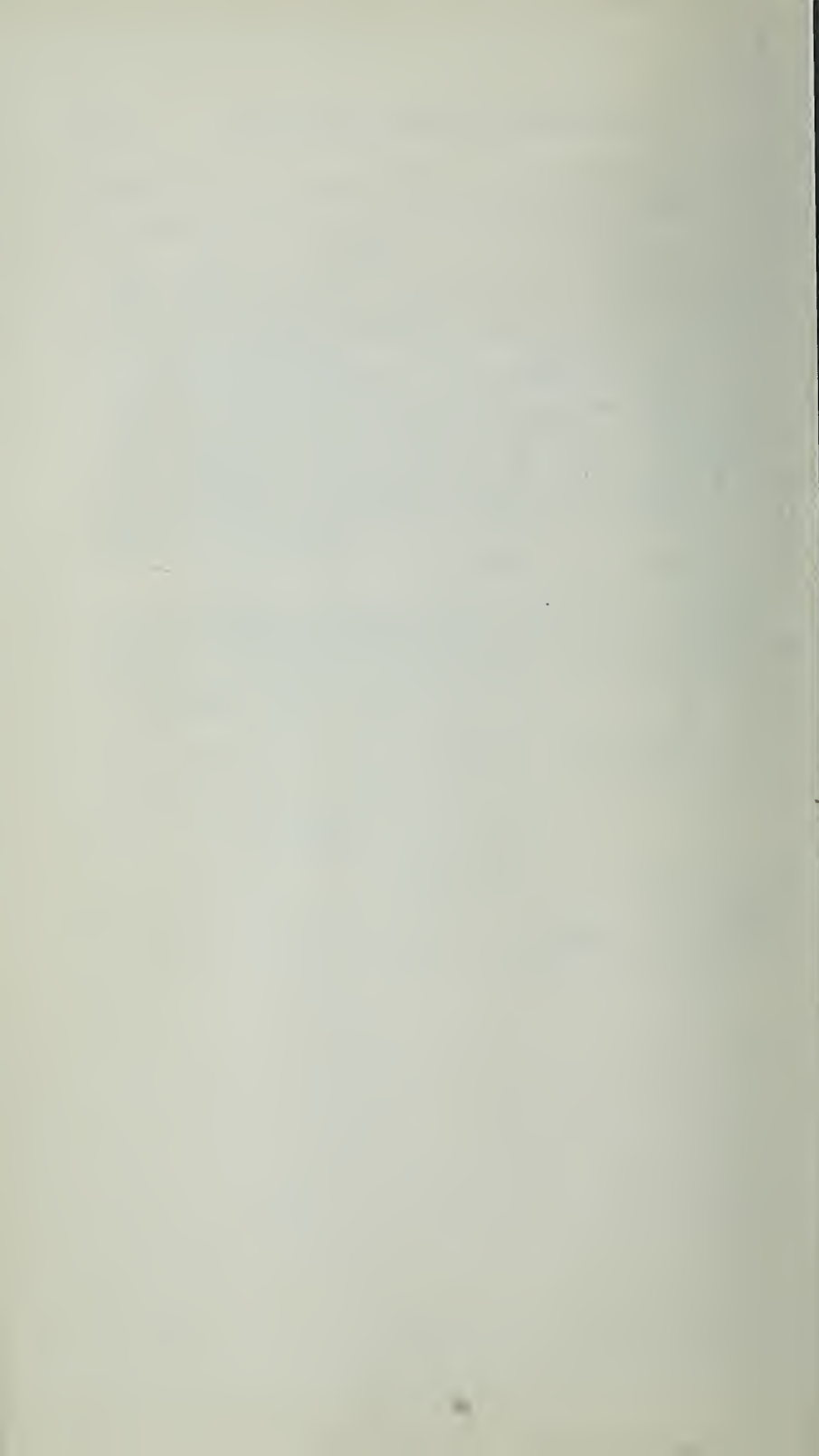
Very truly yours,

/s/ FORD K. EDWARDS,
Director.

Enclosures

cc—Director Dawson

District No. 16



UNITED STATES
CORPORATION INCOME TAX RETURN
For Calendar Year 1950

1950

THE TAX COURT OF THE U. S.
BY 9 ROBERT S. YERGEN
JUN 12 1951
ATTORNEY AT LAW
WASHINGTON, D. C. 20540

or fiscal year beginning 1950, and ending 1951
FIRST CLASSIFY CORPORATION'S NAME AND ADDRESS
ADVANCE TRUCK COMPANY
21740 Alameda St.
Long Beach 16, California
(City or town, postoffice number) (State)
Date incorporated 1923 Date or month, California
Principal business activity (See instruction 10) Trucking and storing
Business year ends under (See instruction 10) 463 Number of shares of common 1

File No. 19
Serial No. 4101582
Date 6-6-51
RECEIVED
WITH REMITTANCE
MAR 15 1951
COLL. INT. DIV.
1700 ANGEL ST. CAL.
Check 52.00 Cash 00.00 B. B.

KEY INCOME COMPUTATION

GROSS INCOME		
1. Gross sales (where inventories are on income-determining basis)		
2. Less: Cost of goods sold. (From Schedule A)		
3. Gross profit from sales		
4. Gross rentals (where inventories are not on income-determining basis)	<u>\$ 284,092 54</u>	
5. Less: Cost of operations. (From Schedule B)	<u>140,629 86</u>	
6. Gross profit when inventories are not on income-determining basis		<u>143,462 68</u>
7. Interest, dividends, net income, bonds, bank deposits, etc.		<u>4,661 66</u>
8. Income from corporations, trusts, etc.		
9. Total gross income		<u>148,124 34</u>
10. Deductions:		
(a) Total net short-term capital gains for excess of net short-term capital gains over net long-term capital loss. (From Schedule C)		<u>1,837 40</u>
(b) Total net long-term capital gains for excess of net long-term capital gains over net short-term capital loss. (From Schedule C)		<u>1,646 50</u>
(c) Net gain for loss from sale or exchange of property other than capital assets. (From Schedule D)		<u>371 25</u>
11. Excess of (a) over (b)		<u>366 15</u>
12. Total deductions from items 8, 9, and 10, inclusive		<u>\$ 187,794 43</u>
13. Corporation of officers. (From Schedule F)		<u>\$ 5,272 00</u>
14. Substantive and other deductions		
15. Total deductions		<u>4,956 69</u>
16. Total income before net operating loss deduction		<u>29,667 47</u>
17. Contributions or gifts paid. (From Schedule I)		
18. Losses by fire, storm, shipwreck, or other casualty, or theft. (Schedule schedule)		<u>32,297 36</u>
19. Depreciation. (From Schedule J)		<u>505 29</u>
20. Depletion of oil, gas, coal, timber, etc. (Schedule schedule)	<u>27.58</u>	
21. Amortization of intangible assets. (Schedule schedule)		<u>441 95</u>
22. Advertising		
23. Amounts contributed under a pension, security, stock bonus, or profit-sharing plan, etc.		<u>17,557 05</u>
24. Other deductions authorized by law. (From Schedule K)		
25. Total deductions from items 16 to 24, inclusive		<u>109,780 27</u>
26. Net income before net operating loss deduction on account of net operating loss carry-over (from item 21)		<u>\$ 78,014 16</u>
27. Less: Net operating loss deduction on account of net operating loss carry-over from two preceding years. (Schedule schedule)		<u>\$ 78,014 16</u>
28. Net income		<u>\$ 0 00</u>
TOTAL INCOME TAX		
29. Total income tax (See item 28, page 2, or item 29 or 30, Form 1120-1, whichever is applicable)		<u>\$ 27,603 51</u>
30. Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation		
31. Balance of income tax due		<u>\$ 27,603 51</u>

DECLARATION. (See instruction K)
We, the undersigned, president for vice president, or other principal officer and treasurer for assistant treasurer, or chief accounting officer of the corporation for which this return is made, each for himself declare under the penalties of perjury that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.
Feb. 21, 1951 W. A. Appleton, President
W. A. Appleton Secretary
(Taxpayer, Assistant Treasurer, or Chief Accounting Officer) (State title)

DECLARATION. (See instruction K)
I, the undersigned, declare under the penalties of perjury that I have prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information required by the law and the regulations issued thereunder.

(Signature of person preparing the return)

(Signature of person preparing the return)

(Date of filing or completion, if any)



Schedule A—COST OF GOODS SOLD. (See instruction 2)
(Show beginning and ending inventories 4-10)

Inventory of beginning of year. _____
Material or merchandise bought for manufacture _____
or sale. _____
Subsides and wages. _____
Other costs per books. (Attach itemized schedule) _____
Total _____
Less: Inventory at end of year _____
Cost of goods sold (insert on Item 3, page 1) _____

Part 2.—COST OF OPERATIONS

(All data are on a log scale)

Polistes annularis

Other events (to be determined):

(c)

462

468

40

993

SCHEDULE ATTACHED

Text set out at 10-11 & 12-13.

Schedule C.—Separate Schedule C (Form 1120) should be obtained and used in reporting sales and exchanges of capital assets and filed with and as a part of this return.

Schedule D.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF PROPERTY OTHER THAN CAPITAL ASSETS. (See instruction 12)

[illegible][illegible]

Schedule E—INCOME FROM DIVIDENDS

[illegible]

Dividends—Shareholders may receive dividends if the company declares dividends. Dividends are usually paid quarterly, but may be paid semi-annually or annually. Dividends are paid to shareholders of record as of the dividend payment date. Dividends are paid to shareholders of record as of the dividend payment date. Dividends are paid to shareholders of record as of the dividend payment date.

Schedule F.—COMPENSATION OF OFFICERS

1. Name and Address of Officer	2. Official Title	3. Years Forwarded to President	4. Percentage of Corporation's Stock Owned	5. Amount of Compensation
			a. Common	b. Preferred
Mr. Appleton 21740 Alameda St., Long Beach	Pres.	100%	83	18,000.00
Mr. Carter 21740 Alameda St., Long Beach	Secty	100%		6,354.4
Total compensation of officers (Enter on Form 16, page 1)				24,354.46

Schedule G.—BAD DEBTS. (See instruction 26) (See note)

1. Filing Date	Amount of Notes and Amount of Cash Received		3. Net Income Reported	5. Sales on Account	6. Total Value of Capital Assets Sold, Property or Other Assets Sold or Carried on	7. Corporation's Capital & Reserves	
	2. Beginning of Year	2. End of Year				7. Gross Amount Added to Reserves	7. Net Change in Capital Account Since 1933
1933				0	0		0
1937							
1942							
1948							
1950							

Somehow obtain two capital gains and avoid income taxation with the transfer year should be reported as follows:

Schedule H—TAXES (See Instructions 22)		Schedule I—CONTRIBUTIONS OR GIFTS PAID (See Instructions 22)	
Amount	Amount	Name and Address of Organization	Amount
Vehicle License & Reg.	11,627 00		
Social Security	4,158 62		
Real Estate	7,597 09		
Miscellaneous	6,284 76		

Schedule I.—CONTRIBUTIONS OR GIFTS PAID. (See instruction 22)

Category	Amount	Name and Address of Organization	Amount
Vehicle License & Reg.	11,627 00		
Social Security	4,158 62		
Real Estate	7,597 09		
Miscellaneous	6,284 76		

2





ADVANCE TRUCK COMPANY
21740 Alameda St., Long Beach 14, Calif.

Year 1950

DEPRECIATION

Truck No.	Make	Date Acquired	Cost	Salvage Value	Balance Depreciable	Depreciation Previously Taken	1950 Dep'n.	Totals
72	White	5-25-46	\$2500.00	\$ 150.00	\$ 2350.00	\$145.00	\$ 150.25	
74	Overhead							
74	Clark	9-21-46	115.73	10.00	105.73	15.30	47.90	
75	Mack	1-18-47	775.03	2.00	773.03	15.00	180.56	
76	Mack	1-18-47	775.03	2.00	773.03	15.00	180.56	
77	Towmotor	2-8-47	3780.00	10.00	3770.00	150.70	537.33	
78	White	4-1-47	8400.44	401.10	7999.34	171.40	176.20	
79	White	4-10-47	8400.44	401.10	7999.34	171.40	176.20	
80	Mack	5-18-47	3750.00	40.00	3710.00	110.00	110.00	
81	Towmotor	5-18-47	3750.00	40.00	3710.00	110.00	110.00	
82	Mack	5-18-47	3750.00	40.00	3710.00	110.00	110.00	
84	Towmotor	11-27-47	1440.00	0.00	1440.00	0.00	1166.31	
85	Mack	12-17-47	1064.38	44.00	1020.38	604.84	177.42	
86	Mack	12-17-47	1064.38	44.00	1020.38	604.84	177.42	
88	Towmotor	5-1-48	430.00	10.00	420.00	0.00	420.00	
89	Mack	8-10-48	1000.00	44.00	956.00	100.00	120.00	
91	Mack	8-21-48	1000.00	44.00	956.00	100.00	120.00	
92	Cushman	10-13-48	1000.00	17.28	982.72	0.00	50.68	
			10750.17	514.41	10235.76	1474.20	1481.07	14,861.06

Trailers:

201	Utility	1-1-44	1400.00	04.35	1395.65	130.30	268.90	
202	"	11-1-44	1800.00	4.35	1795.65	130.30	268.90	
203	"	11-1-44	1800.00	4.35	1795.65	130.30	268.90	
204	"	11-1-44	1800.00	4.35	1795.65	130.30	268.90	
305	"	8-1-45	2410.00	10.00	2400.00	150.00	343.74	
306	"	8-1-45	2410.00	10.00	2400.00	150.00	343.74	
307	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
308	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
309	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
310	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
311	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
312	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
313	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
314	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
315	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
316	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
317	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
318	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
319	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
320	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
321	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
322	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
323	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
324	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
325	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
326	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
327	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
328	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
329	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
330	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
331	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
332	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
333	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
334	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
335	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
336	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
337	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
338	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
339	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
340	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
341	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
342	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
343	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
344	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
345	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
346	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
347	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
348	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
349	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
350	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
351	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
352	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	
353	"	1-1-46	2410.00	10.00	2400.00	150.00	343.74	

Automobiles:

87	Cadillac	5-27-44	1700.00	0.00	1700.00	0.00	0.00	
90	Plymouth	5-25-45	1700.00	0.00	1700.00	0.00	0.00	
93	Cadillac	1-1-45	4000.00	0.00	4000.00	0.00	0.00	
			7400.00	0.00	7400.00	0.00	0.00	1,345.31

Continued Form 1 to Sheet No. 2

27,637.71



ADVANCE TRUCK COMPANY
21740 Alameda St., Long Beach 17, Calif.

Year 1950

DEPRECIATION (CONTINUED)

Buildings & Improvements:	Date Acquired	Cost	Dep'n. Previously Taken	1950 Depreciation	Totals
				Prot Fwd.	\$27,637.71
Fence (Steel)	1-5-39	\$ 4086.58	\$ 2996.84	\$ 272.44	
Fence (Steel)	2-1-49	123.66	113.60	123.00	
Roads	1-5-39	3038.60	2473.64	281.24	
Office Bldg. (Frame)	8-15-39	4800.20	3901.11	326.01	
Roads	10-1-39	1838.00	1141.44	111.36	
Roads	11-17-40	2358.23	1437.01	157.29	
Roads	5-1-41	4303.21	3641.54	420.21	
Garage (Frame)	1-1-42	1076.69	1053.51	131.68	
Office (Frame)	1-1-45	2706.46	722.41	146.60	
Roads	3-1-45	9364.46	880.81	597.57	
Roads	5-1-45	5476.60	1868.96	398.40	
Pipe Racks	11-26-45	817.75	506.88	172.66	
Pipe Racks	6-15-47	4531.62	1747.50	687.54	
Pipe Racks	1-8-48	1928.52	678.56	289.28	
		50,734.65	24,873.51	4,039.65	4,039.65
Spur Track	9-18-43	6200.00	3900.81	620.00	620.00
					32,297.36
					32,297.36

TOTAL DEPRECIATION

RECAP:

Trucks	\$14,861.06
Trailers	11,431.34
Automobiles	1,345.31
Bldgs. & Improvements	4,039.65
Spur Track	620.00
	<u>32,297.36</u>

SCHEDULE B - Cost of Operations:

Salaries and Wages	\$ 110,089.37
Gasoline and Oil	17,569.43
Gasoline Tax	4,362.10
Parts and Repairs	7,012.74
Tires and Tubes	3,304.02
Purchased Transportation	980.00
Misc. Transportation Expense	493.88
Tariffs and Schedules	200.11
	<u>176,039.46</u>

SCHEDULE C - Other Deductions

Light, Power, Heat, Water	\$ 264.05
Insurance	11,439.42
Expenses of General Officers	86.02
Office Supplies & Expenses	1,983.97
Telephones	885.66
Employees Welfare Expense	728.00
General Expense	2,399.00
	<u>17,557.05</u>



Schedule J.—DEPRECIATION. (See Instruction 20)

1. Kind of property, its location, and number of utility connections	2. Date Acquired	3. Cost or Other Basis (Do not include land or other nondepreciable property)	4. Accum. Depreciation (See instructions 17 to 19)	5. Depreciation for the year (See instructions 21 to 23)	6. Remaining Depreciable Basis (See instructions 24 to 26)	7. Depreciation for the year (See instructions 27 to 29)	8. Depreciation for the year (See instructions 30 to 32)	9. Depreciation for the year (See instructions 33 to 35)
SCHEDULE ATTACHED								
Total. (Enter as item 26, page 1)								

Schedule K.—OTHER DEDUCTIONS. (See Instruction 20)

SCHEDULE ATTACHED	
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TAX COMPUTATION. (See Tax Computation Instructions)

CALENDAR YEAR 1969

For other taxable years ending after June 30, 1969, and before December 31, 1981, obtain from Collector Form 11287 and use rules shown therein to compute line tax

1. Net Income (Item 26, page 1)	78,014.16
2. Less: Dividends received credit: (a) Enter 65 percent of income 2, Schedule K. (b) Enter 22 percent of income 2, Schedule K. Total dividends received credit. Enter sum of (a) and (b), above, but not to exceed 22 percent of the amount of item 26, page 1, over the sum of items 3 (a) and 3 (b), page 1.	315.56
3. Credits for dividends paid on certain preferred stock if taxpayer is a public utility. Credits for Waters Hemisphere trade corporations.	315.56
4. Shorter net income.	77,698.60
5. Combined normal tax and surtax. If amount of line 3 is: Not over \$24,000, enter 22 percent of line 3 (22 percent if a consolidated return). Over \$24,000, compute 22 percent of line 3 (22 percent if a consolidated return). Subtract \$4,730. Enter difference.	27,883.41
6. Less: Normal tax adjustment for partially tax-exempt interest; enter 22 percent of the sum of items 3 (a) and 3 (b), page 1, but not in excess of 22 percent of line 3.	
7. Surtax adjustment for partially tax-exempt interest. If amount of line 3 is: Not over \$24,000, enter zero. Over \$24,000, enter 1 percent of the lesser of (a) sum of items 3 (a) and 3 (b), page 1, or (b) line 3 minus \$24,000.	27,883.41
8. Normal tax and surtax.	27,883.41
9. Total tax (line 8, or line 22 of Schedule C)	27,603.51

QUESTIONS

1. If this is the corporation's first return, indicate whether (a) completely new business (), or (b) continuance of previously existing business which was organized as (1) corporation (), (2) partnership (), or (3) sole proprietorship (), or (4) other (indicate). If continuance to previous business, give name and address of the previous business organization.	2. Is this a consolidated return? No (If so, prepare from the indicator of internal revenue for your district Form 551, Affiliated Subsidiaries, which shall be filed in and filed as a part of this return.)
3. Collector's office where the corporation's return for the preceding year was filed: Los Angeles	4. If this is not a consolidated return: (a) Did the corporation own or at any time during the taxable year 50 percent or more of the voting stock of another corporation or other domestic or foreign? No (b) (1) did any corporation, individual, partnership, trust, or association own or at any time during the taxable year 50 percent or more of the corporation's voting stock? No (If either answer is "yes," attach separate schedule showing: (1) Name and address, (2) percentage of stock owned, (3) date stock was acquired, and (4) the taxpayer's action in which the income tax return of such corporation, individual, partnership, trust, or association for the last taxable year was filed.)
5. Enter amount of income (or deficit) from item 22, page 1, Form 1120 for 1968: 77,780.35	6. Is the return made on the basis of cash receipts and disbursements? Yes If not, describe fully in separate statement.
7. The corporation's books are in care of: Leased at	8. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. If other basis is used, explain fully in separate statement, giving date inventory was last reconciled with stock from specific instruction 2.
9. Enter the approximate number of stockholders at the close of the taxable year: 2	9. Did the corporation make a return of information on Forms 1066 and 1069 as Form W-9 for the calendar year 1969 (see Instruction C-1)? Yes
10. Check if the corporation is a farmer, marketing or a farmer's purchasing cooperative association (), a consumer's cooperative association (), or other cooperative association ().	10. Has any transaction described in Instruction C-2 occurred on or after October 3, 1947? (Answer "yes" or "no") No
11. Is the corporation a personal holding company within the meaning of Section 561 of the Internal Revenue Code? No (If so, an additional return on Form 1128-B must be filed.)	11. Did the corporation at any time during the taxable year own directly or indirectly any stock of a foreign corporation? No (If so, attach statement as required by Instruction K-12.)



Schedule L—BALANCE SHEETS. (See Instructions L.)

	Beginning of Taxable Year		End of Taxable Year	
	Amount	Yield	Amount	% Yield
ASSETS				
1. Cash		\$ 6,751.45		
2. Notes and accounts receivable			\$ 18,462.96	30
Less: Reserve for bad debts				18,462.96 ✓
3. Investments:				
(a) Real estate:				
(i) Work in process				
(ii) Finished goods				
(b) Supplies				
4. Investments in governmental obligations:				
(a) Treasury of U. S. Govt., Treasury, or Federal Reserve Bank, or the Federal Reserve Bank of the United States				
(b) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(c) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(d) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(e) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(f) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(g) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(h) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(i) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(j) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(k) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(l) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(m) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(n) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(o) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(p) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(q) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(r) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(s) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(t) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(u) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(v) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(w) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(x) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(y) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
(z) Obligations issued or guaranteed by U. S. Govt. or any agency thereof				
5. Other investments (Specify)				
6. Capital assets:				
(a) Depreciable assets (Specify):				
(i) Buildings & improvements	\$ 63,160.90		\$ 63,160.90	
(ii) Trucks, trailers, equipment	243,774.09		236,704.09	
Total depreciable assets	306,934.99		299,864.99	
Less: Reserve for depletion	153,160.33	153,774.66	178,743.19	121,123.80
(b) Land				
(c) Stocks	\$ 6,475.68	178,313.29	\$ 6,420.93	178,313.29
(d) Notes receivable	87,213.72		93,689.40	98,093.15
			432,528.80	425,644.50
7. Total Assets				196.20
LIABILITIES				
8. Accounts payable				
9. Bonds, notes, and mortgages payable:				
(a) With original maturity of less than 1 year				
(b) With original maturity of 1 year or more				
10. Amounts payable (Specify):				
(a) Taxes withheld	\$ 1,017.17		\$ 2,109.29	31
(b) Other liabilities (Specify):	172.43	1,184.60	40.50	2,149.75
11. Surplus reserves (Specify):				
(a) Preferred stock:				
(i) Preferred stock				
(ii) Common stock	1500			
12. Federal or capital surplus	150,000.00	150,000.00	150,000.00	150,000.00
13. Retained surplus and undivided profits			159,553.95	183,698.67
14. Total Liabilities				432,528.80

Schedule M—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

1. Total distributions to stockholders changed to amount surplus during the taxable year:				
(a) Cash				
(b) Stock of the corporation				
(c) Other property				
2. Contributions or gifts income over 5 percent (Specify):				
3. Federal income and excess profits taxes:				
(a) Income taxes of foreign countries or United States payables if deferred as to credits to which or to part to item 8b, page 1	54,374.73			
4. Federal taxes paid on tax-free corporate bonds				
5. Special depreciation losses resulting to income (a) value of the property concerned				
6. Depreciations, amortizations, and capital expenditures charged to expense on the books				
7. Insurance premiums paid on the life of any officer or employee when the corporation is directly or indirectly a beneficiary				
8. Unavailable interest incurred in purchasing or carrying exempt interest obligations				
9. Items of capital income over capital gains				
10. Additions to surplus reserves (See separately):				
(a)				
(b)				
(c)				
11. Other nondeductible deductions:				
(a)				
(b)				
12. Adjustments for tax purposes not recorded on books (Specify):				
(a)				
(b)				
13. Excess credits to current surplus (Specify):				
(a)				
(b)				
14. Excess credits and undivided profits or shares (a) of stock of the taxable year	183,698.67			
(b)	238,073.46			
15. Total of item 14 to 18				
16. Earned surplus and undivided profits at close of preceding taxable year (Schedule L):			159,553.95	95
17. Net income before non-operating item deductions (item 22, page 1)			78,034.26	26
18. Nontaxable interest on:				
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions				
(b) Obligations of the United States				
(1) Obligations issued on or before September 1, 1917; all serial or refund bonds, Treasury notes issued prior to December 1, 1940, and Treasury bills issued prior to March 1, 1941				
(2) United States savings bonds and Treasury bonds issued to the principal amount of \$5,000 or less, issued prior to March 1, 1941				
(c) Obligations of Federal land banks, joint stock land banks, and Federal land-mortgage credit banks issued prior to March 1, 1941				
19. Other nondeductible income (Specify):				
(a)				
(b)				
20. Charges against surplus reserves deducted from income in the return (Specify):				
(a)				
(b)				
21. Adjustments for tax purposes not recorded on books (Specify):				
(a) Depletion			505.29	
(b)				
22. Surplus credits to current surplus (Specify):				
(a)				
(b)				
23. Total of item 17 to 22			238,073.46	46



CLAIM

TO BE FILED WITH THE DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The Director will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form.

- ☐ REFUND OF TAXES ILLEGALLY, ERRONEOUSLY, OR EXCESSIVELY COLLECTED.
☐ REFUND OF AMOUNT PAID FOR STAMPS UNUSED, OR USED IN ERROR OR EXCESS.
☐ ABATEMENT OF TAX ASSESSED (not applicable to estate, gift, or income taxes).

JAN 1 2 1954

EXHIBIT 61
RESPONDENT'S

DIRECTOR'S STAMP	
(Date received)	
95	JAN 1 1954
DIRECTOR INT REV LOS ANGELES OFFICE - #5	

TYPE
OR
PRINT

Name of taxpayer or purchaser of stamps ADVANCE TRUCK COMPANY

Street address 21740 Alameda Street

City, postal zone number, and State Long Beach 10, California

- District in which return (if any) was filed 6th District California
- Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1 1950 to Dec. 31 1950
- Kind of tax income and excess profits tax
- Amount of assessment, \$29,945.18; dates of payment as prescribed by law
- Date stamps were purchased from the Government
- Amount to be refunded \$ 5,348.06
- Amount to be abated (not applicable to income, estate, or gift taxes)

The claimant believes that this claim should be allowed for the following reason:

Taxpayer erroneously reported income on the accrual basis whereas taxpayer is and always has been on a cash basis.

Tax paid	\$29,945.18
Tax liability per amended return	24,197.12
Refund due	\$ 5,348.06

CERTIFICATE FOR CLAIM ON AMOUNT

I hereby certify that this claim for refund was prepared by me on behalf of the claimant and that the facts stated therein are true and correct to the best of my knowledge and belief.

PAKTHORN: PAKTHORN & PAKTHORN
650 So. Spring Street
Long Beach 14, Calif.

(Attach letter-size sheets if space is not sufficient)

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Dated Jan 7th 1954

Signed Advance Truck Co.
By H. G. Appleton Pres.

(SEE INSTRUCTIONS ON OTHER SIDE)

16-11300-7



[Title of Tax Court and Cause.]

FINDINGS OF FACT AND OPINION

Taxpayer was properly on the cash basis for keeping its books and reporting its tax in 1949 when certain services were rendered. As directed by the Interstate Commerce Commission it changed its method of keeping its books to the accrual method as of January 1, 1950. Held, taxpayer was properly on the accrual method for reporting income in 1950, but must include in income payments received in 1950 for services performed in 1949, under the provisions of section 42, I.R.C. of 1939.

CHARLES H. CHASE, ESQ.,

For the Petitioner.

GEORGE E. CONSTABLE, ESQ.,

For the Respondent.

Opinion

Mulroney, Judge:

Respondent determined a deficiency in the income and excess profits tax of petitioner for the year 1950 in the sum of \$3,618.14. Petitioner does not contest respondent's adjustments which resulted in the deficiency but petitioner claims an overpayment of income tax for said year in the sum of \$5,348.06.

The only question for decision is whether amounts received in 1950 for services rendered in 1949, are includible in 1950 income when petitioner was properly on the accrual basis for reporting income in

that year, and properly on the cash basis for reporting income in 1949.

All of the facts were stipulated and are found accordingly. Petitioner is a corporation organized and existing under the laws of the State of California with its principal place of business in Long Beach, California. During all of the years mentioned herein the petitioner filed its tax returns on a calendar year basis with the then collector of internal revenue for the sixth district of California, Los Angeles, California, and his successor, the district director of internal revenue for the Los Angeles, California district.

The petitioner is a common carrier and is engaged in the business of hauling and storing tubular goods for hire. It does not engage in manufacturing, processing, purchasing or selling merchandise. Its business does not require the use of inventories, and inventories are not an income-producing factor. At no time mentioned herein has the petitioner changed its type of business operation.

From the date of its incorporation through December 31, 1949, it properly kept its books of account and properly reported its income for Federal income tax purposes on the cash receipts and disbursements method.

On January 16, 1950, the petitioner received a letter from the Interstate Commerce Commission informing the petitioner that it was classified as a Class 1 Motor Carrier, and that effective as of

January 1, 1950, the petitioner would be required to keep its accounts in conformity with the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

The system of accounting prescribed by the Interstate Commerce Commission is set forth in Uniform System of Accounts for Class 1 Common and Contract Motor Carriers of Property, Prescribed by the Interstate Commerce Commission in accordance with Part II of the Interstate Commerce Act. The Uniform System of Accounts of the Interstate Commerce Commission prescribes an accrual method of accounting.

Section 222 (g) of the Interstate Commerce Act provides that willful failure or refusal to keep accounts and records in the form and manner prescribed by the Commission shall be a misdemeanor punishable by a fine of not more than \$5,000 for each offense.

In conformity with the directive of the Interstate Commerce Commission the petitioner, as of January 1, 1950, changed its method of accounting to the method prescribed in the Uniform System of Accounts. Petitioner has kept its books and records on an accrual basis commencing January 1, 1950, to the present time.

On or before March 15, 1951, the petitioner filed its income tax return for the calendar year 1950, in which it reported gross receipts from its operations in the amount of \$284,092.54. Included in this

amount was income from services rendered in 1950 of \$18,467.96 which was represented by accounts receivable at December 31, 1950. Also included in gross receipts was the sum of \$20,431.48, which amount was collected during the month of January, 1950, for services rendered during the month of December, 1949. On the accrual method of accounting, the latter amount would have represented accounts receivable at December 31, 1949.

The petitioner reported cost of operations in the amount of \$140,629.46, which sum included the amount of \$196.20 which represented accounts payable at December 31, 1950. The amount of income and excess profits tax shown to be due on the return was the sum of \$27,603.51.

While petitioner stated on said income tax return that said return was made on the basis of cash receipts and disbursements, it actually was prepared on the accrual basis and the parties herein have so stipulated.

On or about December 3, 1951, the petitioner filed an amended income tax return for the calendar year 1950 showing an additional amount of income tax due. The total income and excess profits tax paid by the petitioner for the calendar year 1950 was in the amount of \$29,545.18.

The petitioner has not at any time filed an application requesting the permission of the respondent to change the method of keeping its books of account or manner of reporting its income from a

cash receipts and disbursements method to an accrual method.

On May 11, 1955, respondent issued a notice of deficiency in which he accepted petitioner's income tax return for the calendar year 1950 which was prepared and filed upon the accrual basis. In this statutory notice of deficiency certain adjustments were made which, as stated, are not contested here, but respondent did not eliminate from the petitioner's income for 1950 the accounts receivable at December 31, 1949. Petitioner now concedes that respondent may require the petitioner to report its income on the accrual basis but contends that its income must be recomputed by eliminating the accounts receivable at the beginning of the year 1950.

The sole question here is whether the sum collected in 1950 on 1949 accounts receivable were properly included in 1950 income in view of the fact that petitioner was properly on the cash basis in 1949 and properly on the accrual basis in 1950. Petitioner's contention is that because it was properly on the accrual basis for reporting in 1950, these amounts were not taxable in that year. Respondent asserts that those amounts which were collected in 1950 constitute taxable income in that year regardless of petitioner's change in method of accounting to the accrual basis.

To sustain its position—that the amounts in controversy are not taxable in 1950—petitioner relies upon a line of cases where there was a change in the method of reporting and it was held the Com-

missioner could not include in the year of change to the accrual method, accounts receivable which should have been accrued in the prior year. Petitioner cites *Commissioner v. Mnookin's Estate*, 184 F. 2d 89, affirming 12 T. C. 744; *Robert G. Frame*, 16 T. C. 600, affd. 195 F. 2d 166; *David W. Hughes*, 22 T. C. 1; *Clement A. Bauman*, 22 T. C. 7; *Welp v. United States*, 201 F. 2d 128; *Caldwell v. Commissioner*, 202 F. 2d 112; *Commissioner v. Dwyer*, 203 F. 2d 522; and *Commissioner v. Schuyler*, 196 F. 2d 85.

In none of the cited cases did the taxpayer in the years before the change-over keep its books and compute and report its income on an entirely proper basis. That is an important distinction. In the cited cases the Commissioner was attempting to tax amounts that had not been received or that should have been accrued as income in a prior year not before the Court. That is not true here. The amounts here in controversy had all been received and were not income in 1949 because petitioner at that time was properly reporting income on the cash basis, and the amounts were not received in that year.

Section 42 of the Internal Revenue Code of 1939 provides, in part, that

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under Section 41, any such amounts are to be properly accounted for as of a different period. * * *

It cannot be argued that the receipt of \$20,431.48 in January 1950 for services rendered was anything other than an item of gross income. The narrow question is whether this item for services is includible in gross income in 1949 when the services were rendered or 1950 when the \$20,431.48 was received in payment for said services.

The statute is designed to see to it that all items of gross income shall be properly accounted for in gross income for some year. No item of gross income is to escape. It names the year "in which received" as the proper year to include the item unless, by virtue of some permissible method of accounting, the item is to be properly accounted for as of a different period. Since the \$20,431.48 was received in 1950, that is the year it is to be included in gross income unless petitioner can show the item should have been "properly accounted for" in 1949. Far from showing that this item should have been properly accounted for in 1949, petitioner in effect, stipulates that this item could not have been "properly accounted for" in 1949. That is the full force of the stipulation that petitioner in the year 1949 "properly kept its books of account and properly reported its income for Federal income tax purposes on the cash receipts and disbursements method." In short, the stipulated facts preclude the application of the "unless" clause of the statute.

With no other year for properly accounting for the item the command of the statute is that the year

“in which received” or in this case 1950, is the year the item is to be included in the gross income.

The fact that the change from the cash, to the accrual method of keeping its books was involuntary, and done upon the order of the Interstate Commerce Commission, is not material. Petitioner, when it filed its 1950 return on the accrual basis was merely following section 41, Internal Revenue Code of 1939, by making a conforming change in its method of reporting income. Respondent expressly accepted the change to the accrual method of reporting as he had a right to do. *Josef C. Patchen*, 27 T. C. 592.

Petitioner's argument on brief is that since it was “required” to make the change from cash to accrual method of reporting, the respondent cannot “require the taxpayer to report as income in the year of change items which are not income or do not represent income according to the accrual method.” The answer to this argument is that under section 42, *supra*, every taxpayer is required to report every item of gross income that he receives in some year. It is either the year of receipt or some other year when it could be properly accounted for. When, as here, there is no other year when it could properly be accounted for, then the fact that the year of receipt is an accrual year for reporting, is immaterial. The statute does not say the item shall be included in income in the year of receipt, if that would be proper according to the method of accounting then being employed by the taxpayer. The method of accounting of the taxpayer in the year of receipt, and

whether that method was the result of a voluntary or involuntary change-over, are both immaterial.

Decision will be entered for the respondent.

Filed January 20, 1958.

Served January 20, 1958.

Tax Court of the United States
Washington

Docket No. 59010

ADVANCE TRUCK COMPANY, a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Opinion, filed January 20, 1958, it is:

Ordered and Decided: That there is a deficiency in income and excess profits tax for the year 1950 in the amount of \$3,618.14, and that there is no overpayment in such tax due to petitioner for said year.

[Seal] /s/ JOHN E. MULRONEY,
Judge.

Entered January 29, 1958.

Served January 31, 1958.

On or about January 14, 1954 the petitioner filed a timely claim for refund with the respondent claiming an overpayment of taxes for the taxable year 1950 on the grounds that it was properly on the cash basis for the purposes of reporting its income for Federal income and excess profits. On May 11, 1955 the respondent issued a notice of deficiency in which he rejected petitioner's claim for refund and determined that petitioner was required to report its income on the accrual method. The respondent made certain adjustments to petitioner's income which were not contested in the Tax Court. The petitioner claimed in its petition to the Tax Court that if the respondent's determination that the petitioner was required to report its income on the accrual method was correct, its income for the calendar year 1950 should be recomputed by eliminating from gross receipts the accounts receivable at December 31, 1949, which on the accrual method of accounting were not income to the petitioner in 1950. Such a recomputation would result in an overpayment by petitioner of its income and excess profits tax for the calendar year 1950.

The Tax Court in its opinion held that the petitioner was required to report its income for Federal income tax purposes on the accrual method for the calendar year 1950 and that under the provisions of Section 42, 1939 Internal Revenue Code, the accounts receivable at December 31, 1949 were income of the petitioner in the year 1950 when received.

On the basis of its opinion, the Tax Court entered its decision that there was no overpayment in in-

come and excess profits due to the petitioner for the year 1950.

Wherefore, it is prayed that this Honorable Court review the matters set forth herein and reverse the decision of the Tax Court of the United States.

Respectfully submitted,

/s/ CHARLES H. CHASE,
Counsel for Petitioner on
Review.

Of Counsel:

/s/ L. A. LUCE.

Received and filed April 14, 1958, T.C.U.S.

[Title of Court of Appeals and Cause.]

Tax Court Docket No. 59010

STATEMENT OF POINTS TO BE
RELIED UPON

Advance Truck Company, a corporation, petitioner on review submits the following Statement of Points upon which it intends to rely as the basis of its petition for review.

That the Tax Court of the United States erred.

1. In finding as a fact that the petitioner's income and excess profits tax return for the taxable year 1950 was actually prepared on the accrual basis. This fact was not stipulated by the parties, and the finding is not supported by the evidence.

1957

Nov. 12—Reply Brief for Petitioner filed. Served
11/18/57.

1958

Jan. 20—Opinion filed. Judge Mulroney. Decision
will be entered for respondent.

Jan. 29—Decision entered, Judge Mulroney. Served
1/31/58.

Apr. 14—Petition for review by U.S. Ct. of Ap.
9th Cir., filed by petitioner.

Apr. 14—Proof of service of petitioner for review
filed.

Apr. 14—Statement of Points with proof of serv-
ice thereon filed.

Apr. 14—Designation of Contents of Record on Rev.
with proof of service thereon filed by
petitioner.

Apr. 14—Notice of filing Designation of Contents
of Record on Review with proof of service
thereon filed.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of
the United States, do hereby certify that the fore-
going documents, 1 to 11, inclusive, constitute and
are all of the original papers on file in my office as
called for by the "Designation of Contents of Rec-
ord", including Joint Exhibits 1-A, 2-B, and 6-F,

attached to Stipulation of Facts, in the case before the Tax Court of the United States docketed at the above number and in which the petitioner in the Tax Court has filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case, as the same appear in the official docket of my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 7th day of May, 1958.

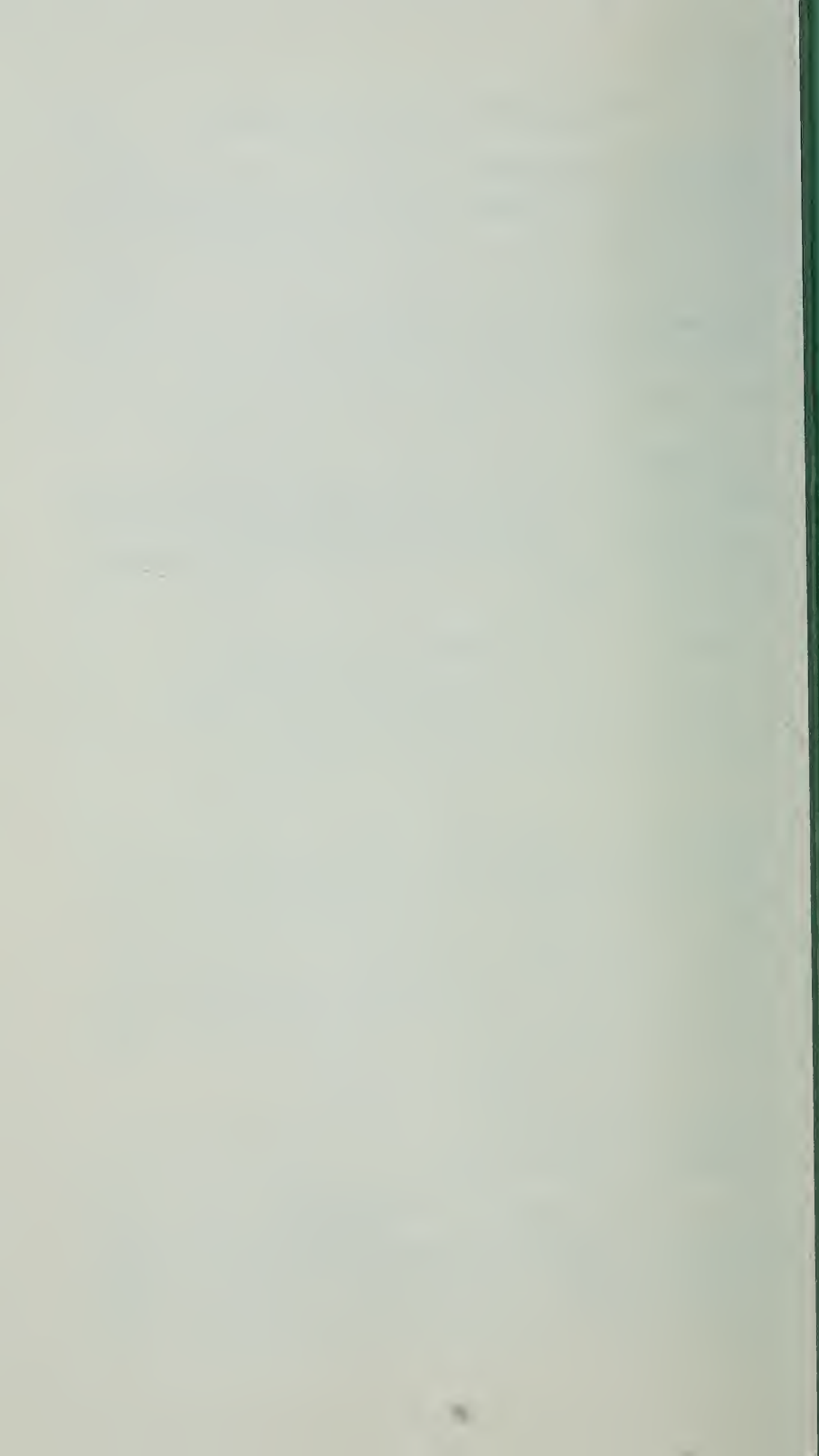
[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Endorsed]: No. 16024. United States Court of Appeals for the Ninth Circuit. Advance Truck Company, a Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: May 19, 1958.

Docketed: May 22, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.



No. 16024

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ADVANCE TRUCK COMPANY, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR THE PETITIONER WITH APPENDICES.

CHARLES H. CHASE,
PARKER, MILLIKEN & KOHLMEIER,
650 South Spring Street,
Los Angeles 14, California,
Attorneys for Petitioner.

FILED
MAY 21 1964
U.S. COURT OF APPEALS
NINTH CIRCUIT
LOS ANGELES, CALIF.

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No. 16024

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ADVANCE TRUCK COMPANY, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR THE PETITIONER WITH APPENDICES.

Opinion Below.

The findings of fact and opinion of the Tax Court [R. 39-47] are reported at 29 T. C. 666.

Jurisdiction.

This petition for review [R. 48-51] involves federal income and excess profits taxes for the taxable year 1950. On May 11, 1955, the Commissioner of Internal Revenue mailed to Petitioner a notice of deficiency in the total amount of \$3,618.14 [R. 9-16]. Within 90 days thereafter and on August 3, 1955, the Petitioner filed a petition for redetermination of that deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954 [R. 3-16]. The decision of the Tax Court was entered on January 29, 1958 [R. 47]. The case was brought to this Court by a petition for review filed on

April 14, 1958 [R. 48-51]. Jurisdiction is conferred on this Court by Sections 7482 and 7483, 1954 Internal Revenue Code.

Question Presented.

The Petitioner, prior to the year 1950, kept its books of account and reported its income for federal income tax purposes on the cash receipts and disbursements method. Pursuant to a directive of the Interstate Commerce Commission, the Petitioner, on January 1, 1950, changed its method of keeping its books of account to an accrual method.

The Question presented is whether the Petitioner's income for federal income tax purposes for the year 1950 is to be computed according to the strict accrual method as contended by the Petitioner, or whether, as the Tax Court held, the income is to be computed by a hybrid method, which is a partly cash receipts and disbursements method and a partly accrual method.

Statutes and Regulations Involved.

The relevant portions of the statutes and regulations involved are set forth in Appendix A, *infra*.

Statement.

The stipulated facts [R. 20-27] may be summarized as follows:

The Petitioner is a common carrier and is engaged in the business of hauling and storing tubular goods for hire. It does not engage in manufacturing, processing, purchasing or selling merchandise. Its business does not require the use of inventories and inventories are not an income-producing factor. From the date of its incorporation through December 31, 1949, it properly kept its books of account and properly reported its income for

federal income tax purposes on the cash receipts and disbursements method [R. 20-21].

As of January 1, 1950 the Petitioner, pursuant to a directive of the Interstate Commerce Commission [R. 21, 27-29], changed its method of keeping its books of account to an accrual method [R. 23].

In reporting its income for the calendar year 1950 the Petitioner included in the gross receipts in its income tax return the accounts receivable at December 31, 1950. Petitioner also included in the gross receipts shown on the return an amount received during January 1950 for services rendered during the month of December 1949, which on the accrual method of accounting would have represented accounts receivable at December 31, 1949 [R. 23].

On or about January 14, 1954, the Petitioner filed a timely claim for refund with the Respondent claiming an overpayment of taxes for the taxable year 1950 on the grounds that it was properly on the cash basis for the purposes of reporting its income for federal income and excess profits taxes [R. 25, 37]. On May 11, 1955, the Respondent issued a notice of deficiency [R. 9-16] by which he rejected the Petitioner's claim for refund and determined that the Petitioner was required to report its income on the accrual method [R. 11]. The respondent made certain adjustments to Petitioner's income which were not contested in the Tax Court. The Petitioner claimed in its petition to the Tax Court that if the Respondent's determination that the Petitioner was required to report its income on the accrual method was correct, its income for the calendar year 1950 should be computed by eliminating from gross receipts the accounts receivable at December 31, 1949, which on the accrual method of

accounting were not income to the Petitioner in the year 1950 [R. 4, 7-8]. Such a recomputation would result in an overpayment by the Petitioner of its income and excess profits tax for the calendar year 1950.

The Tax Court in its opinion held that the Petitioner was required to report its net income for federal income tax purposes on the accrual method for the calendar year 1950, and that under the provisions of Section, 42, 1939 Internal Revenue Code, the accounts receivable at December 31, 1949 were income of the Petitioner in the year 1950 when received [R. 43, 45-46].

On the basis of its opinion, the Tax Court entered its decision that there was no overpayment in income and excess profits taxes due to the Petitioner for the year 1950 [R. 47].

Specifications of Error.

The Tax Court of the United States erred:

1. In holding that under the provisions of Section 42, 1939 Internal Revenue Code, the accounts receivable at December 31, 1949 were income of the Petitioner in the taxable year 1950 when received, when Petitioner was required to change to an accrual method of reporting its income for the taxable year 1950.

2. In failing to hold that the Petitioner was entitled to have its income for the taxable year 1950 recomputed by the elimination of amounts which were not income to the Petitioner for the taxable year 1950 according to the accrual method of accounting.

3. In failing to hold and decide that there is an overpayment in income and excess profits tax due to the Petitioner for the taxable year 1950 in an amount to be determined under Rule 50 of the Rules of Practice of the Tax Court.

Summary of Argument.

The Tax Court's interpretation of Section 42, 1939 Internal Revenue Code, is contrary to and in conflict with Section 41, 1939 Internal Revenue Code. The interpretation of Section 42 by that Court is opposed to the decided cases and is based on the identical reasoning of *Hardy v. Commissioner* (C. A. 2, 1936), 82 F. 2d 249, which has been overruled.

Argument.

Section 41, Internal Revenue Code of 1939, provides that a taxpayer's net income shall be computed upon the basis of the taxpayer's annual accounting period in accordance with the method of accounting employed in keeping the books of the taxpayer, unless the method employed does not clearly reflect net income, in which case it shall be computed in accordance with such method as in the opinion of the Commissioner does clearly reflect net income. The Tax Court found that during the year 1950 the Petitioner, Advance Truck Company, maintained its books of account on an accrual method of accounting [R. 41]. It further found that on the accrual method of accounting the amounts received during January 1950 for services rendered during December 1949 would have represented accounts receivable at December 31, 1949 [R. 42]. The annual accounting period of the Petitioner was a calendar year [R. 20]. On the accrual method of accounting an item is included in income when earned and not when received. (*Graham Mill & Elevator Co. v. Thomas* (C. A. 5, 1945), 152 F. 2d 564, 565.) On the accrual method of accounting, the accounts receivable at December 31, 1949 were not income in the year 1950, and on an annual basis of taxation may not

be included in income for 1950. (*Robert G. Frame* (1951), 16 T. C. 600, aff'd (C. A. 3, 1952), 195 F. 2d 166.)

"All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period . . ."

Burnet v. Sanford & Brooks Co., 282 U. S. 359, 363, 51 S. Ct. 150, 75 L. Ed. 383:

Security Flour Mills Co. v. Commissioner, 321 U. S. 281, 64 S. Ct. 596, 88 L. Ed. 725.

The method of accounting employed by a taxpayer in keeping his books of account controls as to the time as of which items of gross income are to be accounted for, unless the *method* employed does not clearly reflect his income. (Regulation 111, Sec. 29.41-1.) Method of accounting means the way of keeping the taxpayer's books according to a definite and regular plan. (*Huntington Securities Corp. v. Busey* (C. A. 6, 1940), 112 F. 2d 368, 370.) The Respondent has determined [R. 11] and the Court has found that during the taxable year 1950 the accrual method was the proper basis for keeping the Petitioner's books and reporting its income. The Commissioner has not contended nor did the Court find that the accrual method did not clearly reflect the Petitioner's income for the year 1950.

The Tax Court's interpretation of Section 42, Internal Revenue Code of 1939, as requiring the inclusion in gross income of the amounts received in 1950 for services rendered in 1949 is in conflict with and contrary to the provision of Section 41, Internal Revenue Code of 1939. Section 42 provides that all items of gross income shall

be included in the gross income of the taxpayer for the taxable year in which received unless under methods of accounting permitted under Section 41 they are to be accounted for as of a different period. The Tax Court's interpretation of Section 42, as applied to the facts of this case, is illustrated by the following language from its opinion [R. 46-47]:

“The answer to this argument is that under section 42, *supra*, every taxpayer is required to report every item of gross income that he receives in some year. It is either the year of receipt or some other year when it could be properly accounted for. When, as here, there is no other year when it could be properly accounted for, then the fact that the year of receipt is an accrual year for reporting, is immaterial. The statute does not say the item shall be included in income in the year of receipt, if that would be proper according to the method of accounting then being employed by the taxpayer. The method of accounting of the taxpayer in the year of receipt, and whether that method was the result of a voluntary or involuntary change-over, are both immaterial.”

Under Section 41, net income is computed in accordance with the method employed in keeping the books of the taxpayer. “Net income” is defined in Section 21, Internal Revenue Code of 1939, as the “gross income” less “deductions.” Under the Tax Court opinion the Petitioner's gross income is to be computed upon a basis which is neither cash nor accrual. Under the provisions of Section 41, however, its net income, which is gross income less deductions, is to be computed according to its books of account which for the taxable year 1950 were maintained on an accrual method. The Tax Court's interpretation of Section 42 renders meaningless the pro-

visions of Section 41 since it would be an impossibility to compute gross income for a taxable period in one way under Section 41 and another way under Section 42. It is significant that the Court cited no authority for its holding, which is contrary to the Respondent's regulations and the decided cases. Regulation 111, Section 29.41-1, states in part:

"Sec. 29.41-1. *Computation of net income.* Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. * * * If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. * * *"

The courts have held, in interpreting Sections 41, 42 and 43, 1939 Internal Revenue Code, that neither income nor deductions may be taken out of the proper accounting period for the benefit of the Respondent or the taxpayer.

"But we think it was not intended to upset the well understood and consistently applied doctrine that cash receipts or matured accounts on one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer."

Security Flour Mills Company v. Commissioner,
supra.

The controversy herein involved arose by reason of the change of accounting method between two taxable years. Neither the Internal Revenue Code of 1939, nor its predecessors, prescribed the tax consequences of a transition from the cash to the accrual method. The attempt by the Tax Court to attribute to Section 42 that prescription as applied to the facts of this case is contrary to the decided cases. The reasoning of the Tax Court in this proceeding is precisely the same as in *William Hardy, Inc. v. Commissioner* (C. A. 2, 1936), 82 F. 2d 249, which was specifically overruled by *Commissioner v. C. J. Dwyer* (C. A. 2, 1953), 203 F. 2d 522. In *Hardy*, the taxpayer changed its method of keeping its books of account from a cash to an accrual method. The Respondent, in the year of changeover, required the income to be computed and reported on the accrual basis and additionally included in the income for the year of changeover the accounts receivable at December 31 of the prior year. The Court stated:

“The accounts receivable at December 31, 1924 were correctly included also. They were not taxable on the cash basis and if strict accrual principles are to prevail beginning with January 1, 1925 they never would be taxable since they represent previous transactions which could not be accrued in 1925 or thereafter nor would payments made upon them after the beginning of 1925 figure in the computation of income since the cash basis no longer was to be used. Yet to the extent that they were thereafter paid they were in fact the income of the petitioner. There is no provision in the law which permits them escape from taxation if received. *On the contrary Sec. 213(a) of the 1926 Act required that all income received by a taxpayer in any taxable year should be reported in that year unless under permitted methods*

of accounting it was properly to be accounted for as of a different period. These accounts receivable were therefore correctly added to the net income reported by the petitioner for 1925 as though they had actually accrued in that period.” (Emphasis supplied.)

The portion of Section 213(a) of the 1926 Revenue Act referred to by the Court is identical to Section 42 of the Internal Revenue Code of 1939. Since the Tax Court's reasoning has been disavowed by the overruling of the *Hardy* case, it follows that there is no authority for its holding in this proceeding.

The Tax Court and various Circuit Courts have since *Hardy* considered the tax effects of a change in the manner of reporting income. (*Goodrich v. Commissioner* (C. A. 8, 1957), 243 F. 2d 686; *Dwyer, supra*; *Caldwell v. Commissioner* (C. A. 2, 1953), 202 F. 2d 112; *Welp v. United States* (C. A. 8, 1953), 201 F. 2d 128; *Commissioner v. Cohn* (C. A. 2, 1952), 196 F. 2d 1019; *Commissioner v. Schuyler* (C. A. 2, 1952), 196 F. 2d 85; *Commissioner v. Frame* (C. A. 3, 1952), 195 F. 2d 166; *Commissioner v. Mnookin's Estate* (C. A. 8, 1950), 184 F. 2d 89; *David W. Hughes* (1954), 22 T. C. 1; *Clement A. Bauman* (1954), 22 T. C. 7; *E. S. Iley* (1952), 19 T. C. 631, overruled by *Hughes, supra*.) In some of these cases, *e.g.*, *Mnookin's Estate*, the taxpayer's books were kept on an accrual basis, but part of the income was reported on a cash basis. In other cases, *e.g.*, *Welp*, *Goodrich*, *Iley*, the books were kept and income reported on a cash basis. The Commissioner in each of the above cited cases determined that the taxpayer was required to report the income on an accrual basis and attempted in the year of changeover to require the taxpayer to include in income accounts receivable of

prior years, or denied the taxpayer the right to use opening inventories. The courts in the above cases have unanimously held that on the changeover from a cash to an accrual method of reporting income the strict accrual method must be used in computing income for the taxable year of the changeover. All of the foregoing cases have distinguished or disavowed the *Hardy* rationale and have held that the Commissioner does not have the right, under Section 41 of the Internal Revenue Code of 1939, to prescribe a hybrid method of reporting income as the Tax Court has held in this case. The Tax Court in its opinion [R. 44] distinguished the cited cases on the basis that these were cases in which the taxpayers did not keep their books or report income on an entirely proper basis and that the Commissioner was attempting to tax amounts that had not been received or that should have been accrued as income in a prior year not before the court. This distinction, if valid, would explain the cases in which the taxpayers kept books on an accrual basis, but reported income on a cash basis, but it does not explain such cases as those in which the taxpayer kept its books and reported its income on a cash basis. In such cases as *Welp, supra*, *Goodrich, supra*, and *Iley, supra*, the taxpayer was following the requirements of Section 41 and reporting income on the basis of its accounting method. Accounts receivable could not be properly accrued in years prior to the changeover under Section 42 because the accounting method used in the prior years was a cash method as in the case of the Petitioner here. The distinction is without merit if the provisions of Section 41 are to be followed. It is submitted that all of the cited cases have been decided on a consistent interpretation of Section 41.

The Tax Court in *Robert G. Frame, supra*, stated that Section 41, 1939 Internal Revenue Code, did not give the Commissioner the authority to add to a taxpayer's gross income for a given year an item which rightfully belongs in an earlier year under the accrual method of accounting, citing *Clifton Mfg. Co. v. Commisisoner* (C. A. 4, 1943), 137 F. 2d 290, and *Security Flour Mills Co. v. Commissioner, supra*. Similarly, the Court of Appeals for the Eighth Circuit held in *Commissioner v. Mnookin's Estate, supra*, that the Commissioner had no authority under Section 41 to disregard the taxpayer's accounting methods in determining the time as of which an item is reported. It is submitted that if Section 41 does not so empower the Commissioner, then Section 42 cannot be construed so to do. An additional indication of the lack of authority under the provision of the Internal Revenue Code of 1939 is the fact that Congress found it necessary to enact Section 481 of the 1954 Internal Revenue Code to provide authority for making adjustments upon a change of the method of accounting. (Sen. Rept. No. 1622, 83rd Cong., 2nd Sess., p. 307.)

Conclusion.

For the reasons stated above, the decision of the Tax Court should be reversed.

Respectfully submitted,

CHARLES H. CHASE,
PARKER, MILLIKEN & KOHLMEIER,
Attorneys for Petitioner.

August, 1958.

APPENDIX A.

STATUTES.

1939 Internal Revenue Code.

SEC. 21. NET INCOME.

(a) DEFINITION.—“Net income” means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in Section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) GENERAL RULE.—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. . . .

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS
TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. . . .

Revenue Act of 1926 (44 Stat. 23).

GROSS INCOME DEFINED.

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by

the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

United States Treasury Department Regulations.

REGULATIONS 111.

Sec. 29.41-1. *Computation of net income.*

. . . Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.42-1. *When included in gross income.*

(a) In general.—Except as otherwise provided in section 42, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. . . .

APPENDIX B.

Table of Exhibits Pursuant to Rule 2(f) as Amended.

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**In the United States Court of Appeals
for the Ninth Circuit**

**ADVANCE TRUCK COMPANY, A CORPORATION,
PETITIONER**

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**On Petition for Review of the Decision of the
Tax Court of the United States**

BRIEF FOR THE RESPONDENT

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1955, taxpayer filed a petition, under the provisions of Section 272(a)(1) of the Internal Revenue Code of 1939, for redetermination of that deficiency. (R. 3-16.) The decision of the Tax Court was entered on January 29, 1958. (R. 47.) The case is brought to this Court by a petition for review filed on April 14, 1958. (R. 51.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court correctly held that the amounts received by the taxpayer in 1950 for services rendered in 1949 are includible in 1950 income when taxpayer properly reported income on the accrual basis in 1950 and properly reported income on the cash basis in 1949.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Section 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 42.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.41-1. *Computation of Net Income.*—
* * * The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. * * *

Sec. 29.41-2. *Bases of Computation and Changes in Accounting Methods.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See sec-

tion 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

The true income, computed under the Internal Revenue Code and, if the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation), shall in all cases be entered in the return. * * *

A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. * * * Application for permission to change the method of accounting employed and the basis upon which the return is made shall be filed within 90 days after the beginning of the taxable year to be covered by the return. The application shall be accompanied by a statement specifying the classes of items differently treated under the two methods and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. See section 22(d) and regulations

thereunder with respect to changing to optional method of inventorying goods.

* * * *

Sec. 29.42-1. *When Included in Gross Income.*—(a) *In general.*—Except as otherwise provided in section 42, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See sections 29.41-1 to 29.41-3, inclusive.) * * *

* * * *

STATEMENT

All the facts have been stipulated and found by the Tax Court accordingly. (R. 40.) They may be stated as follows:

Taxpayer is a corporation organized and existing under the laws of the State of California with its principal place of business in Long Beach, California. During all of the years mentioned herein the taxpayer filed its tax returns on a calendar year basis. (R. 40.)

The taxpayer is a common carrier and is engaged in the business of hauling and storing tubular goods for hire. It does not engage in manufacturing, processing, purchasing or selling merchandise. Its business does not require the use of inventories, and inventories are not an income-producing factor. At no time mentioned herein has the taxpayer changed its type of business operation. (R. 40.)

From the date of its incorporation through De-

cember 31, 1949, it properly kept its books of account and properly reported its income for federal income tax purposes on the cash receipts and disbursements method. (R. 40.)

On January 16, 1950, the taxpayer received a letter from the Interstate Commerce Commission informing the taxpayer that it was classified as a Class 1 Motor Carrier, and that effective as of January 1, 1950, the taxpayer would be required to keep its accounts in conformity with the Uniform System of Accounts prescribed by the Interstate Commerce Commission. (R. 40-41.)

The system of accounting prescribed by the Interstate Commerce Commission is set forth in Uniform System of Accounts for Class 1 Common and Contract Motor Carriers of Property, Prescribed by the Interstate Commerce Commission in accordance with Part II of the Interstate Commerce Act. The Uniform System of Accounts of the Interstate Commerce Commission prescribes an accrual method of accounting. (R. 41.)

Section 222(g) of the Interstate Commerce Act provides that willful failure or refusal to keep accounts and records in the form and manner prescribed by the Commission shall be a misdemeanor punishable by a fine of not more than \$5,000 for each offense. (R. 41.)

In conformity with the directive of the Interstate Commerce Commission the taxpayer, as of January 1, 1950, changed its method of accounting to the method prescribed in the Uniform System of Accounts. The taxpayer has kept its books and rec-

ords on an accrual basis commencing January 1, 1950, to the present time. (R. 41.)

On or before March 15, 1951, the taxpayer filed its income tax return for the calendar year 1950, in which it reported gross receipts from its operations in the amount of \$284,092.54. Included in this amount was income from services rendered in 1950 of \$18,467.96 which was represented by accounts receivable at December 31, 1950. Also included in gross receipts was the sum of \$20,431.48, which amount was collected during the month of January, 1950, for services rendered during the month of December, 1949. On the accrual method of accounting, the latter amount would have represented accounts receivable at December 31, 1949. (R. 41-42.)

The taxpayer reported cost of operations in the amount of \$140,629.46, which sum included the amount of \$196.20 which represented accounts payable at December 31, 1950. The amount of income and excess profits tax shown to be due on the return was the sum of \$27,603.51. (R. 42.)

While the taxpayer stated on the income tax return for 1950 that the return was made on the basis of cash receipts and disbursements, as has been stipulated, it actually was prepared on the accrual basis. (R. 42.)

On or about December 3, 1951, the taxpayer filed an amended income tax return for the calendar year 1950 showing an additional amount of income tax due. The total income and excess profits tax paid

by the taxpayer for the calendar year 1950 was in the amount of \$29,545.18. (R. 42.)

The taxpayer has not any time filed an application requesting the permission of the Commissioner to change the method of keeping its books of account or manner of reporting its income from a cash receipts and disbursements method to an accrual method. (R. 42-43.)

On May 11, 1955, the Commissioner issued a notice of deficiency in which he accepted taxpayer's income tax return for the calendar year 1950 which was prepared and filed upon the accrual basis. In this statutory notice of deficiency, certain adjustments were made which are not contested here but the Commissioner did not eliminate from taxpayer's income for 1950 the accounts receivable at December 31, 1949 in the amount of \$20,431.48. (R. 43.)

Taxpayer now concedes that the Commissioner may require it to report its income on the accrual basis but contends that its income must be recomputed by eliminating the accounts receivable at the beginning of the year 1950. (R. 43.)

The Tax Court sustained the Commissioner's determination that the accounts receivable at December 31, 1949—representing amounts actually received in January, 1950, for services performed in 1949—should not be eliminated from 1950 income because the amounts were received in 1950 and are not “properly accounted for”, under Section 42, Internal Revenue Code of 1939, in any year other than 1950. (R. 44-46.)

SUMMARY OF ARGUMENT

Taxpayer's cash method of computing its net income for 1949 was properly in accordance with its accounting method employed in keeping its books. The accounts receivable involved would not constitute income to taxpayer for tax purposes until received by it. The uncollected accounts receivable at the end of 1949 were not properly reportable as income by taxpayer in that year because payment had not been received by taxpayer. The accounts receivable did not accrue as income to taxpayer in 1949 because taxpayer was properly on the cash method in 1949.

If the accrual method had been proper in 1949, the accounts receivable would have accrued in that year. However, taxpayer changed to the accrual method in maintaining its books and reporting its income in 1950. Also, in that year taxpayer collected the accounts receivable which, indisputably, constitute an item of income. Having received, in 1950, an item of income which is not "properly accounted for" as of a different period, taxpayer must include the amount thereof in its 1950 income. The accounts receivable had a tax cash basis established for them and the year of receipt continued to determine the time when they were taxable. If taxpayer had continued in 1950 to maintain its books and report income on the cash method as it had done since its incorporation, unmistakably the amount involved would be includible in its 1950 income.

If the amount involved is not includible in taxpayer's 1950 income, it will be omitted entirely and

escape taxation. The Internal Revenue Code does not contemplate such a result. An adjustment such as here is ordinarily the kind of adjustment required by the Commissioner when a taxpayer seeks the Commissioner's consent to change his accounting method.

The cases following the principle of the *Mnookin's Estate* case are not applicable because in those cases the taxpayers had reported income on an improper accounting method prior to the years in controversy.

The Committee Reports show that Section 481 of the Internal Revenue Code of 1954 does not indicate any lack of authority by the Commissioner to make the adjustment required here. Moreover, that Section is only applicable to taxable years not here involved.

Accordingly, the Tax Court correctly held that the amounts which were received in 1950 for services rendered in 1949 are includible in taxpayer's 1950 income when taxpayer properly reported income on the accrual basis for 1950 and properly reported income on the cash basis for 1949.

ARGUMENT

The Tax Court Correctly Held That The Amounts Received By The Taxpayer In 1950 For Services Performed In 1949 Are Includible In 1950 Income When Taxpayer Properly Reported Income On The Accrual Basis For 1950 And Properly Reported Income On The Cash Basis For 1949

Section 41, Internal Revenue Code of 1939, *supra*, requires the computation of net income upon the basis of a taxpayer's annual accounting period in ac-

cordance with the method of accounting regularly employed in keeping such taxpayer's books.¹ It has been stipulated by the parties that from the date of its incorporation through December 31, 1949, taxpayer properly kept its books of account and reported its income for federal income tax purposes on the cash receipts and disbursements method. (R. 21, 40.). The amount involved, i.e., \$20,431.48 which was included by the taxpayer in its original and first amended income tax returns for 1950 but which it now seeks to eliminate from gross income for that year represents on the accrual method of accounting accounts receivable at the end of 1949 for services performed in 1949. (R. 42.) This sum was not included in taxpayer's 1949 income tax return, in accordance with taxpayer's proper cash method of reporting income, because the sum was not received in 1949. Accrual of this sum in 1949 was not appropriate because taxpayer maintained its books and properly reported its income on the cash basis. (R. 40.)

Two significant events occurred in 1950: (1) Taxpayer changed the method of keeping its books from the cash method to the accrual method (R. 41), and (2) taxpayer received, in January, 1950, the entire

¹ If the method of accounting does not clearly reflect taxpayer's income, Section 41 authorizes the Commissioner to compute the income in accordance with such method as in his opinion does clearly reflect income. It is the Commissioner's position that the cash method in 1949 and the accrual method in 1950 were proper here. No question of taxpayer's method clearly reflecting income, therefore, is involved for the year in question.

sum representing the accounts receivable at the end of 1949 for services performed during 1949 (R. 42).

Conformably to Section 41 which as noted requires a taxpayer to compute net income in accordance with the method of accounting regularly employed in keeping its books, taxpayer properly reported its income for 1950 based upon the same method employed in maintaining its books, the accrual method.²

There is no dispute that the amount involved is an item of income. As we will show it must be included in taxpayer's income for 1950, as the Tax Court held.

Section 42, Internal Revenue Code of 1939, *supra*, requires the inclusion of *all* items of gross income in the gross income for the taxable year in which received by taxpayer, "unless, under methods of accounting permitted under section 41, any such amounts are to be *properly accounted for* as of a different period." (Italics supplied.) As the Tax Court said (R. 45):

² Treasury Regulations 111, Section 29.41-2, *supra*, in order to promote consistent accounting practices from year to year, requires a taxpayer who changes his method of accounting in keeping his books to obtain the Commissioner's consent before computing his income upon such new method for tax purposes. Taxpayer did not secure the Commissioner's consent here (R. 42-43), but the Commissioner has accepted the change as he has a right to do (R. 43). *Fowler Bros. & Cox v. Commissioner*, 138 F. 2d 774, 776 (C.A. 6th); *Geometric Stamping Co. v. Commissioner*, 26 T.C. 301, 304-305; *Gus Blass Co. v. Commissioner*, 9 T.C. 15, 35. In any event, taxpayer concedes that the Commissioner may require it to report its 1950 income on the accrual basis. (R. 43.)

The statute is designed to see to it that all items of gross income shall be properly accounted for in gross income for some year. No item of gross income is to escape. It names the year "in which received" as the proper year to include the item unless, by virtue of some permissible method of accounting, the item is to be properly accounted for as of a different period. Since the \$20,431.48 was received in 1950, that is the year it is to be included in gross income unless petitioner can show the item should have been "properly accounted for" in 1949. Far from showing that this item should have been properly accounted for in 1949, petitioner in effect, stipulates that this item could not have been "properly accounted for" in 1949. That is the full force of the stipulation that petitioner in the year 1949 "properly kept its books of account and properly reported its income for Federal income tax purposes on the cash receipts and disbursements method." In short, the stipulated facts preclude the application of the "unless" clause of the statute.

Since under Section 42, the amount in question may not be properly accounted for in 1949, it must be included in taxpayer's income for 1950, the year "in which received". *Sivley v. Commissioner*, 75 F. 2d 916, 917 (C.A. 9th); *Ross v. Commissioner*, 169 F. 2d 483 (C.A. 1st); *Goodrich v. Commissioner*, 243 F. 2d 686 (C.A. 8th). See also *Healy v. Commissioner*, 345 U. S. 278.

The inclusion of the amount in question in taxpayer's 1950 income obviously increases its income and its tax. This result, however, is not due to any

fault of the Commissioner. Had taxpayer continued in 1950 to maintain its books and report income on the cash basis, as it had done since its incorporation, unmistakably the amount involved would be includible in its 1950 income. Treasury Regulations 111, Section 29.42-1, *supra*.

The Commissioner did not compel taxpayer to change its accounting method. However, "When the method of reporting income is changed it is necessary in certain cases to make some adjustment to protect the taxpayer and the revenue." *Gus Blass Co. v. Commissioner*, 9 T.C. 15, 34. If taxpayer had requested the Commissioner's consent to change its accounting method, an adjustment to take into account the amount involved is the type of adjustment contemplated and necessary in order to prevent a loss of revenue and a windfall to taxpayer. See Treasury Regulations 111, Section 29.42-2, *supra*. As this Court has said (*Kahuku Plantation Co. v. Commissioner*, 132 F. 2d 671, 674):

It is practically impossible to shift from one complicated accounting system to another without some distortion and *it is the duty of the Commissioner* to provide in the agreement for the change in accounting that the distortion is not at a loss to the Government's income. * * *
[Italics supplied.]

See also *Gus Blass Co. v. Commissioner*, *supra*; *Goodrich v. Commissioner*, *supra*.

Since a taxpayer who complies with the Regulations and seeks the Commissioner's consent to change his accounting method must agree to an adjustment,

similar to the inclusion in taxpayer's 1950 income here, before the Commissioner's consent is obtained, certainly this taxpayer, not having requested the Commissioner's consent, is not entitled to a favored position. Nor does the nature of taxpayer's business, subject as it was to regulation by the Interstate Commerce Commission, entitle taxpayer to a favored position. In this connection the Tax Court aptly stated (R. 46):

The fact that the change from the cash, to the accrual method of keeping its books was involuntary, and done upon the order of the Interstate Commerce Commission, is not material.

Taxpayer cites *Goodrich v. Commissioner*, *supra* (Br. 10), and refers to that case saying (Br. 11):

The courts in the above cases have unanimously held that on the changeover from a cash to an accrual method of reporting income the strict accrual method must be used in computing income for the taxable year of the changeover.

This is not an accurate statement pertaining to the *Goodrich* case which unequivocally supports the Commissioner's contention here. In the *Goodrich* case, the established cash basis status of the item of income was controlling, not taxpayer's strict accrual method. The court said (p. 691):

The accounts involved had had an income status created for them on a cash-realization basis, under the accounting method which the taxpayer had employed as to them. This established status of taxability for the particular accounts could hardly be said, we think, to have

been altered by the taxpayer's change in his method of accounting designed to create a different status simply as to his future sales. The previous accounts were not assets which bore an inseparable relationship to his future sales, either as a matter of business operation or of tax payment, and economically the realization of income from them on the basis of their cash status would not in any way be effected by his accrual treatment of his future sales. The previously accumulated bills receivable were assets which he had treated and left as involving a realization of income to him when they were paid. As a matter of fact, the record indicates that he continued so to recognize them in the years subsequent to 1949, by reporting as income and paying tax on such cash as he realized from them in each year.

Clearly, therefore, the Court of Appeals in the *Goodrich* case held that, since the use of the cash method was proper in the year prior to the change, the accounts receivable of that year retained their cash basis character, hence, the taxable event of *receipt* continued to determine when they would be taken into income. The amount of the accounts receivable in that case did not escape taxation. Since the receipt of the amounts involved in the *Goodrich* case was spread over several years, the Court of Appeals remanded the case to the Tax Court for redetermination of the tax due in the year before the Tax Court, taking into account the amount of the accounts receivable received in that year.

Applying the principle of the *Goodrich* case to the facts here, the amount in question was includible in

taxpayer's 1950 income because taxpayer received in that year *all* of the accounts receivable which had "an income status created for them on a cash-realization basis, under the accounting method which the taxpayer had employed as to them." See also *Walker v. Commissioner*, decided May 8, 1956 (1956 T.C. Memorandum Decisions, par. 56,110).

Including this amount in the taxpayer's income for 1950 is entirely in accordance with the fundamental rule that income tax liability is to be computed on the basis of an annual accounting based upon facts existing during the annual tax period in question.³

³ As stated by the Supreme Court in the *Healy* case (pp. 281, 284-285) :

One of the basic aspects of the federal income tax is that there be an annual accounting of income. Each item of income must be reported in the year in which it is properly reportable and in no other. * * *

* * * *

Congress has enacted an annual accounting system under which income is counted up at the end of each year. It would be disruptive of an orderly collection of the revenue to rule that the accounting must be done over again to reflect events occurring after the year for which the accounting is made, and would violate the spirit of the annual accounting system. This basic principle cannot be changed simply because it is of advantage to a taxpayer or to the Government in a particular case that a different rule be followed.

Again the Supreme Court stated in the *Security Mills Co.* case, *supra* (pp. 286-287) :

This legal principle has often been stated and applied. The uniform result has been denial both to Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount.

Healy v. Commissioner, 345 U. S. 278; *Security Mills Co. v. Commissioner*, 321 U. S. 281; *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359.

Taxpayer's reliance upon cases as typified by *Commissioner v. Mnookin's Estate*, 184 F. 2d 89 (C.A. 8th) (Br. 10-11), is misplaced. In those cases, in years prior to the year in controversy, a method other than the accrual method of reporting income improperly had been employed.⁴ In accordance with the proper accrual method for those taxpayers, the amounts representing the accounts receivable in dispute would have accrued prior to the controverted year of change to the accrual method. The courts denied the Commissioner the right to include the amount in dispute in income for the year of change because such amounts were taxable only in the prior year when they accrued since those taxpayers should *properly* have been required to report on the accrual basis in such prior years. As we have pointed out taxpayer here concedes that reporting its income on

⁴ Four of the cases, *Welp v. United States*, 201 F. 2d 128 (C.A. 8th); *Commissioner v. Dwyer*, 203 F. 2d 522 (C.A. 2d); *Commissioner v. Schuyler*, 196 F. 2d 85 (C.A. 2d), and *Bauman v. Commissioner*, 22 T.C. 7, involve deducting in the year of change to the accrual method amounts representing the opening inventory for the year of change to the accrual method. The courts denied the Commissioner the right to disallow the deduction. The amount of the opening inventory for the year of change to the accrual method would not have been deductible in a year prior to the year of change. However, because those taxpayers improperly reported on the cash basis in prior years, the amounts representing opening inventory for the year of change had been deducted as purchases in a prior year.

the cash basis for 1949 was *proper* as was reporting its income on the accrual basis in 1950. (R. 40, 43.) The amount here could not have been accrued in 1949 as we have shown. The *Mnookin's Estate* case and those cases following its principle, therefore, are inapposite.

Taxpayer asserts that the Tax Court's reasoning is precisely the same as that in *William Hardy, Inc. v. Commissioner*, 82 F. 2d 249 (C.A. 2d), which the Second Circuit overruled in *Commissioner v. Dwyer*, 203 F. 2d 522. This is indeed a specious argument. The *Hardy* case is distinguishable on the same ground as those cases typified by the *Mnookin's Estate* case, i.e., taxpayer in the *Hardy* case improperly reported on the cash basis in the year prior to the change to the accrual method. If taxpayer had always properly reported on the accrual method, the accounts receivable would have accrued prior to the controverted year of change. Here, if taxpayer had reported income on the accrual method in 1949, and if that method were proper, the accounts receivable would have accrued in that year and this tax controversy could not have arisen. The sum representing accounts receivable was included in the taxpayer's income in the year of receipt in both the *Goodrich* and *Walker* cases, *supra*. Likewise, the amount of the accounts receivable here should be included in this taxpayer's income in the year of receipt, 1950, and the fact that the Second Circuit overruled the *Hardy* case is not controlling here.⁵

⁵ To the extent, however, that the overruling of the *Hardy* case may be considered at variance with the result required

Taxpayer's argument that its strict accrual method of 1950 controls all items ignores the fact of its change in accounting in that year and Section 42. The Tax Court said (R. 46-47):

The answer to this argument is that under section 42, *supra*, every taxpayer is required to report every item of gross income that he receives in some year. It is either the year of receipt or some other year when it could be properly accounted for. When, as here, there is no other year when it could properly be accounted for, then the fact that the year of receipt is an accrual year for reporting, is immaterial. The statute does not say the item shall be included in income in the year of receipt, if that would be proper according to the method of accounting then being employed by the taxpayer. The method of accounting of the taxpayer in the year of receipt, and whether that method was the result of a voluntary or involuntary change-over, are both immaterial.

Contrary to taxpayer's assertion (Br. 12), Section 481 of the Internal Revenue Code of 1954 does not indicate a lack of authority on the part of the Commissioner under the Internal Revenue Code of 1939 to make an adjustment as here. Section 481(a) provides:

by applying the principle of the *Goodrich* and *Walker* cases, which were decided after the *Hardy* case was overruled, we submit that the overruling of the *Hardy* case deserves re-examination.

SEC. 481. ADJUSTMENTS REQUIRED BY CHANGES
IN METHOD OF ACCOUNTING.

(a) *General Rule.*—In computing the taxpayer's taxable income for any taxable year (referred to in this section as the "year of the change")—

(1) if such computation is under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed, then

(2) there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted, except there shall not be taken into account any adjustment in respect of any taxable year to which this section does not apply.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 481.)

The Committee Reports⁶ recognize that every item of

⁶ H. Rep. No. 1337, 83rd Cong., 2d Sess., p. A164 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4303):

If there is a change in the method of accounting employed in computing taxable income from the method employed for the preceding taxable year, adjustments must be made in order that every item of gross income or deduction is taken into account and that none are omitted. At the same time no item is to affect the computation of taxable income more than once. It is only those omissions or doubling ups which are due to the change in method which must be adjusted.

Under present law these adjustments are made whenever the taxpayer requests permission to change his

income must be taken into account and that none are to be omitted. Moreover, it is pointed out that under present law adjustments are made whenever a taxpayer requests permission to change his accounting method. The only instance noted where the Commissioner has been denied authority to make adjustment is when he forces taxpayer to change his accounting method. The Commissioner has not forced taxpayer to make a change in the instant case. Therefore, the instance recognized in the report does not prevail here and Section 481 does not indicate any lack of authority by the Commissioner to make the adjustment here required. Furthermore, that Section with minor exceptions not here material is only applicable to taxable years beginning after 1953. See Section 7851 of the 1954 Code.

CONCLUSION

In 1949, taxpayer properly kept its books and reported its income for federal tax purposes based on the cash method. Its uncollected accounts receivable, therefore, did not constitute income in 1949. These uncollected amounts were not accruable in 1949 because taxpayer properly reported income on

method of accounting. Where the Commissioner forces a taxpayer to change his method of accounting because the old method does not clearly reflect income, various court decisions have denied the Commissioner the right to make the necessary adjustments.

S. Rep. No. 1622, 83d Cong., 2d Sess. p. 307 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4947), contains identical language.

the cash method. When taxpayer changed its accounting to the accrual method in 1950, it properly reported its income on the accrual method. The uncollected 1949 accounts receivable which were paid in 1950 are includible in taxpayer's 1950 income because the amounts were received in that year and such amounts are not "properly accounted for" as of a different period. Accordingly, the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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SEPTEMBER, 1958.



No. 16024

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ADVANCE TRUCK COMPANY, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR THE PETITIONER.

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No. 16024

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

ADVANCE TRUCK COMPANY, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR THE PETITIONER.

A canon of statutory interpretation is that the parts of a statute are to be construed together to produce a harmonious and consistent result. The opinion below and the Respondent in his brief construe Section 42, 1939 Internal Revenue Code to be independent of and unrelated to Section 41, Internal Revenue Code. It is submitted that there is no conflict between the two provisions.

Under Section 41, the net income is to be computed upon the basis of the taxpayer's annual accounting period in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, but if the method of keeping the books does not clearly reflect the income, the computation is to be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. The Respondent concedes (Br.

11) that the accrual method of accounting clearly reflects the Petitioner's income for the year 1950. The Respondent further concedes (Br. 7), that on the accrual method of accounting the amounts collected during January, 1950, for services rendered in 1949, would have represented accounts receivable at December 31, 1949. Therefore, the two requirements of Section 42 are here met. The accrual method is a method of accounting permitted under Section 41 and under this method of accounting the items of gross income, *i.e.*, accounts receivable, are properly accounted for *as of* a different period than the taxable year in which received by the taxpayer.

Section 42 means only that items of gross income are to be accounted for according to the method of accounting employed by the taxpayer in the taxable year of reporting. This is borne out by the Respondent's own regulation [Reg. 111, Sec. 29.42-1] which provides that the method of accounting determines the year of inclusion of items of gross income (Pet. Br. App. A. 4). Thus interpreted there is no conflict between Sections 41 and 42.

As pointed out by the Tax Court in *V. T. H. Bien* (1953), 20 T. C. 49, there is almost perfect circuitry of reasoning between Sections 41, 42 and 43, 1939 Internal Revenue Code, but the key language as exemplified by Sections 41 and 43 is "clearly reflect the income." There can be no quarrel with the Respondent's statement (Br. 17) that income tax liability is to be computed upon an annual basis. That is required by the statute, the regulations and case law. The Respondent has conceded that the accrual method of accounting *clearly* reflects the Petitioner's income for the year 1950. How then can the inclusion of income for another period according to the accrual method clearly reflect the results of the Peti-

tioner's operations for 1950? The receipts were not earned in 1950 according to the accrual method and their inclusion has the effect of putting 13 months earnings into the calendar year 1950.

None of the cases cited by the Respondent in his brief support his contention as to Section 42 (Br. 13). *Sivley v. Commissioner* (C. A. 9, 1935), 75 F. 2d 916, involved a question of the statute of limitations. *Ross v. Commissioner* (C. A. 1, 1948), 169 F. 2d 483, involved the question of constructive receipt. *Healy v. Commissioner*, 345 U. S. 278, 97 L. Ed. 1007, involved the question as to whether corporate salary payments found by the Commissioner to be excessive compensation should be excluded from income in the year of receipt or whether an adjustment should be made in a later year when the taxpayer was required to pay income tax deficiencies as a transferee of the corporation's assets.

Goodrich v. Commissioner (C. A. 8, 1957), 243 F. 2d 686, extensively relied upon by the Respondent here does not support his position, but on the contrary is squarely in favor of the Petitioner.

In *Goodrich*, the taxpayer prior to 1949 used a hybrid method of keeping his books and making his returns. Sales were recorded and reported on a cash basis while an accrual basis was used as to other elements. On January 1, 1949, the taxpayer changed his method of accounting to a strict accrual basis and reported his income on this basis for the calendar year 1949. The Commissioner audited the taxpayer's return for the year 1949 and determined that the accounts receivable accumulated prior to 1949 should be includible in the taxpayer's income in the year of changeover. The Tax Court sustained the determination of the Commissioner on the grounds that a tax-

payer may not change his method of accounting without first obtaining the consent of the Commissioner and that as a condition of granting his consent the Commissioner has the right to impose such terms and conditions as he deems appropriate to prevent income from otherwise escaping taxation. Therefore, a taxpayer who changed his method of accounting without first obtaining consent is subject to the same adjustment order as one who does. (*William H. Goodrich* (1956), 25 T. C. 1235.) The Court of Appeals reversed the decision below on the grounds that Section 41 and the regulations did not empower the Commissioner to impose upon a taxpayer such conditions as he saw fit but only such conditions as to which the Commissioner and the taxpayer agree. The Court of Appeals specifically held that the Commissioner could not add to the income for the year 1949 the accounts receivable of prior years, since under Section 41, 1939 Internal Revenue Code, the accounts receivable were not income of the taxpayer, *Goodrich*, in the year 1949 under the method of accounting followed by him in that year, *i.e.*, the accrual method. The Court cited as its authority *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281, 64 S. Ct. 596, 88 L. Ed. 725. It should be noted that the Court did not cite Section 42, 1939 Internal Revenue Code in its opinion.

The Respondent asserts that the Court of Appeals in the *Goodrich* case held that the taxpayer there must report the accounts receivable as they are received and that the case was remanded to the Tax Court for a redetermination of the tax due taking into account the amounts of accounts receivable received in the year before the Court (Br. 15-16). This is pure flight of fancy on the part of the Respondent. There is no language in the opinion of

the Court of Appeals which states that the case was remanded for a determination of the tax due taking into account collections on accounts receivable as they were collected. The finding of fact of the Court below would preclude such a result. The Tax Court in its opinion, 25 T. C. 1235, 1236, stated that the taxpayer, Goodrich, reported his income on a strict accrual basis for the years 1949 and 1950. The language of the Court of Appeals stated by the Respondent to be a holding does not even rank as dictum. It is apparent that the Court regarded the action of the taxpayer, Goodrich, in reporting collections of the accounts receivable in later years as a voluntary act not required by any provision of the Internal Revenue Code. Whether he did or did not is questionable in view of the findings of fact of the Tax Court. The Court specifically stated that even if the income escaped taxation altogether, the Commissioner could not tax the accounts receivable in the year of changeover.

The Respondent suggests (Br. 19, n. 5) that the case of *William Hardy, Inc. v. Commissioner* (C. A. 2, 1936), 82 F. 2d 249, is compatible in principle with *Goodrich v. Commissioner, supra*. It is submitted that the same Court of Appeals which disavowed the *Hardy* decision in its opinion in *Welp v. Commissioner* (C. A. 8, 1953), 201 F. 2d 128, did not intend to re-establish the *Hardy* rationale in its later opinion.

The opinion of the Eighth Circuit in *Goodrich* is also a complete answer to the Respondent's contention (Br. 14-15) that since this is the usual type of adjustment required by him where a taxpayer requests permission to change his method of accounting, he can impose such an adjustment unilaterally where the taxpayer changes his method of accounting without first obtaining his consent.

The Petitioner, more than a year before the issuance of the notice of deficiency, filed a claim for refund for the year 1950 on the basis that it should have reported its income on a cash basis [R. 10, 37]. The Respondent in his notice of deficiency rejected this claim for refund and stated that the Petitioner was required to report on the accrual basis [R. 11-12]. A claim for refund is a statutory remedy for the correction of an error by the taxpayer in the reporting of income. (*Crosley Corporation v. United States* (C. A. 6, 1956), 229 F. 2d 376.) The denial of Petitioner's claim was a determination by the Commissioner that Petitioner was required to report on the accrual basis. The situation is the same as if the Petitioner had reported its 1950 income on the cash basis and the Commissioner had later determined a deficiency on the grounds that the Petitioner should have reported on the accrual method. In the latter situation the Courts have uniformly denied the Commissioner the right to add to a taxpayer's income for the year of changeover the accounts receivable of prior years.

The Petitioner admits that if the accounts receivable at December 31, 1949, are not included in its income for the year 1950, they will escape taxation. This fact does not require the affirmance of the decision below. The result of all of the cases which have considered the question, whether it involved opening inventories or accounts receivable, has been to relieve the taxpayer of taxation on part of his income. This fact emphasizes that the 1939 Internal Revenue Code was deficient on the problem herein involved. It was for this reason that Congress enacted Section 481, 1954 Internal Revenue Code. At the same time Congress refused to make the new provision retro-

active in its application to taxable years beginning before the effective date of the 1954 Internal Revenue Code (Sen. Rept. No. 1622, 83rd Cong. 2nd Sess., p. 65).

It should be noted that the Court of Appeals in *Goodrich, supra*, considered the problem there presented as one which prompted the enactment of Section 481, 1954 Internal Revenue Code.

Conclusion.

The appellate courts which have considered the question presented by this appeal have uniformly held that under Section 41, 1939 Internal Revenue Code, the taxpayer's method of accounting controls the time as of which income must be reported. It is agreed by the Respondent that the accrual method of accounting clearly reflects the Petitioner's income for the calendar year 1950, which is the year before this Court. Therefore, the strict accrual method must be followed. There is no authority for the hybrid method advocated by the Respondent. It follows that the decision of the Tax Court must be reversed.

Respectfully submitted,

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October 13, 1958.



United States
COURT OF APPEALS
for the Ninth Circuit

KLAMATH MEDICAL SERVICE BUREAU,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S BRIEF

Appeal from the Tax Court of the United States

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No. 16025

United States
COURT OF APPEALS
for the Ninth Circuit

KLAMATH MEDICAL SERVICE BUREAU,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S BRIEF

Appeal from the Tax Court of the United States

**STATEMENT OF PLEADINGS AND
BASIS FOR JURISDICTION**

This is an appeal from a decision of the Tax Court of the United States which affirmed in part the determination of the Commissioner of Internal Revenue that

corporation income tax deficiencies exist as to the petitioner for the fiscal years ending June 30, 1951, 1952 and 1953. Appellate jurisdiction and venue are granted this Court by 26 USCA, Sections 7482(a) and 7482(b) (1). The Tax Court had jurisdiction by virtue of 26 USCA, Section 7442.

STATEMENT OF THE CASE

The petitioner is an Oregon corporation, organized in 1939, primarily engaged in the business of selling prepaid medical, surgical and hospital plans or contracts in Klamath County, Oregon, and providing the medical and surgical services and the hospitalization required under such plans or contracts (Tr. 50 to 53). A primary source of petitioner's income is the premiums paid upon the prepaid medical, surgical and hospital contracts or plans. Petitioner also derives income from non-contract patients for use of petitioner's hospital facilities (Ex. G, Tr. 151 to 155).

To meet its obligations for supplying medical, surgical and hospital services to those paying premiums under the contracts or plans, the petitioner entered into employment contracts with all of the physicians and surgeons of the Klamath County Medical Society. The employment contract with each physician and surgeon was the same, and the employment contracts (Ex. 23, Tr. 105) between the petitioner and the physicians and surgeons reads in part:

“(1) In consideration of the benefits accruing to him, the Physician agrees to furnish professional services to the Bureau subscribers. * * *

“(3) The charges made by each Physician for services to members shall be initially based on the amounts provided by the Bureau fee schedule as now filed, but said schedule of fees is subject to change by the board of directors provided that notice of change is given in writing within three days to each Physician and that minimum fees not be reduced without prior notice. As full compensation for services rendered by Physicians hereunder, the Bureau agrees to pay and the Physician agrees to accept such percentage of each Physician's base fees charged and approved during each six month period prior to June 30 and December 31 of each year as the total net income of the Bureau for such period, less such amount as the board of directors determined should be retained for corporate purposes, bears to the total fees of all the Physicians during said period. Payment of 50% of the base fee shall be made within thirty days after billing and the balance at the end of each six month period.”

The fee schedule in use in the years in question and referred to in paragraph 3 of the employment contracts is set forth in Ex. 12, Tr. 77. Such fee schedule specifies a flat amount for various types of medical services. The amounts set forth in the fee schedules are the “base fees” referred to in the employment contract. For example, a chronic appendectomy is \$100.00, a tonsilectomy and adanoidectomy is \$45.00 and a gastrotomy \$175.00 (see Ex. 12). After performing medical or surgical services under his employment contract, a doctor submits a bill to the petitioner for the base fee specified in the fee schedule for the particular service rendered. The bill is submitted by the doctor to petitioner, and not to the patient receiving the services (Tr. 168). Within 30 days after receiving a bill from a doctor for

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No. 16025

United States
COURT OF APPEALS
for the Ninth Circuit

KLAMATH MEDICAL SERVICE BUREAU,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF OF PETITIONER

Appeal from the Tax Court of the United States

ARGUMENT

**a. Respondent ignores economic realities
dictating the compensation arrangement.**

Respondent's brief, like the Tax Court's opinion, chooses to ignore the economic realities which dictated the compensation arrangement between petitioner and the member physicians. The economic realities logically account for certain features erroneously referred to by the Tax Court and respondent as being indicative of profit distributions rather than payment of compensation for services rendered.

Petitioner was engaged primarily in the business of selling prepaid medical, surgical and hospital plans or contracts in Klamath County, Oregon, and providing the medical and surgical services and the hospitalization required under such plans or contracts. Petitioner is obligated under the plans to provide all the covered medical and surgical services required by the subscribers. The theory and purpose of prepaid medical, surgical and hospital plans is to provide for an undetermined quantity of medical services (depending upon the needs of the subscriber) for fixed periodic payments which can be budgeted by the subscribers. Consequently, the income of petitioner from the sale of the prepaid plans is fixed, while the amount of medical services to be performed pursuant to the plans is variable.

While the aggregate medical services required under prepaid plans may tend to average out over all the plans, the exact effect of such average cannot be relied upon, at least for a cross-section of subscribers as narrow as Klamath County.

It is elementary economics that costs cannot exceed income in any sound financial operation. Since petitioner's income was fixed, the only way in which petitioner could be sure that the costs did not exceed income was to make the costs dependent upon income. The costs of petitioner consisted primarily of compensation payable to physicians performing the medical services required under the prepaid plans.

Petitioners' obvious solution was to devise an arrangement under which the compensation to the physi-

cians could not exceed the income remaining after deducting sums retained for corporate purposes. This is exactly what Paragraph 3 of the employment contract accomplishes.

b. Respondent misconceives true import of petitioner's brief.

Not only does respondent fail to recognize the economic realities dictating the compensation arrangement attacked by him, but as indicated by the below quoted portion from his brief (Br. 13-14), respondent misconceives the true import of petitioner's brief:

"If a distribution is not compensation, it quite obviously cannot under any circumstances be classified as "reasonable" compensation. Therefore, the pivotal question in this case is whether or not the excess payments were compensation for services or distributions of income. This issue has been largely ignored by the taxpayer on appeal, who has briefed extensively the question of whether or not compensation was reasonable or unreasonable."

Petitioner's brief is directed to a consideration of the specifications of error set forth therein. The first specification of error is the ultimate finding and conclusion of the Tax Court that the payments to doctors in excess of 100 per cent of the base fees specified in the fee schedule constituted distributions of profits rather than compensation. Respondent's statement of the pivotal issue is merely a rephrasing of petitioner's first specification of error. Petitioner's second, third and fourth specifications of error necessarily involved the same issue, such specifications being directed toward the subsidiary findings and conclusions upon which the Tax

Court bases the forementioned ultimate finding and conclusion.

Respondent is not justified in his accusation as to petitioner's briefing of the question of reasonableness, either in regard to the length or purpose of petitioner's consideration of this question. While reasonableness is a separate requirement for deductibility apart from the question of whether the payments are compensation, reasonableness is also an element often considered in determining whether payments constitute compensation or distribution of profits. The relationship between the amount of the payments purportedly made for services and the value of the services rendered obviously has a bearing upon whether the payments constitute compensation.¹

c. Factors conclusively requiring compensation recognition.

Although a finding of reasonableness may be considered as evidence of the fact that the payments in question were compensation, such finding is not a prerequisite to substantiation of petitioner's contention that payments in excess of base fees were compensation. If respondent desires to exclude any consideration of reasonableness from the determination of whether the payments in excess of base fees constituted compensation or distribution of profits, petitioner is willing to adopt such

¹ This is evident from a reading of Treasury Regulation Sec. 39.23 (a)-6 as well as the cases of *Doernbecher Mfg. Co. vs. Commissioner*, 95 F.2d 296; *Am-Plus Storage Battery Co. vs. Commissioner*, 35 F.2d 167; and *Marble & Shattuck Chair Co. vs. Commissioner*, 39 F.2d 393. These authorities are all cited in respondents's brief.

approach. Excluding reasonableness as an element to be considered, the following uncontroverted factors dictate the conclusion that the payments in excess of base fees were compensation rather than distributions of profits:

1. The payments were purportedly made as compensation.

2. The payments were made in direct proportion to the services actually rendered.

3. The payments were not in proportion to stock holdings of the recipients, but in fact were greatly disproportionate.

It is petitioner's pure and simple proposition that the combined existence of the foregoing uncontroverted factors necessitates the conclusion that the payments were compensation, and precludes any finding that the payments were distributions of profits. While every proposition may have exceptions in unusual circumstances, petitioner has been unable to find any case, and respondent has cited none, where the foregoing three factors have been present and the payments have been considered distributions of profit rather than compensation.² In fact, petitioner has been unable to

² In the following cases cited by respondent, it was found both that the payments made were unreasonable in amount and were substantially in proportion to stock holdings: *Doernbecher Mfg. Co. vs. Commissioner*, 95 F.2d 296; *Am-Plus Storage Battery Co. vs. Commissioner*, 35 F.2d 167; *Marble & Shattuck Chair Co. vs. Commissioner*, 39 F.2d 393.

In the cases of *R. H. Oswald Co. vs. Commissioner*, 185 F.2d 6, certiorari denied, 340 U.S. 953; *E. Wagner & Son vs. Commissioner*, 93 F.2d 816; and *Becker Bros. vs. United States*, 7 F.2d 3, there was a finding that the payments made were unreasonably excessive. In *Heil Beauty Supplies vs. Commissioner*, 199 F.2d

find any reported case in which the Commissioner has previously contended that payments were distributions of profits rather than compensation where such three factors existed.

How can payments made in direct proportion to services actually rendered and disproportionate to stock holdings be seriously considered as anything other than compensation for services rendered? Do the laws of economics or human nature permit the serious imagination of any situation where a corporation would distribute earnings and profits as a dividend in direct proportion to services actually rendered and disproportionate to the stock ownership of the recipients?

d. Respondent practically ignores subsidiary findings and conclusions of Tax Court.

Since the Tax Court and respondent recognize the existence of the three factors set forth above, how do they purport to avoid the conclusion dictated by such three factors? The ultimate finding and conclusion of the Tax Court, that the payments in excess of base fees constituted a distribution of profits rather than compensation, is based on the following subsidiary findings and conclusions:

1. The contract between petitioner and the member physicians is ambiguous with respect to the compensation to be paid for services.

2. The following factors outside the employment contract resolve the ambiguity in the employ-

193, it was found that the payments bore no relationship to services rendered and that the services were of no economic value to the taxpayer corporation.

ment contract in favor of the interpretation that the doctors had obligated themselves under the contract to render services to petitioner for fees equal to those set forth in the base fee schedule and the contract does not require or specifically provide for payments of compensation to the doctors in excess of the base fees set forth in the fee schedule:

- (a) Two of the contracts by which petitioner sells its services to subscribers provide that petitioner's member physicians accept petitioner's fees as payment in full for services to subscribers.
- (b) In determining the book value of petitioner's stock for purposes of transferring shares thereof, only 100% of base fee billings are treated as Accounts Payable by petitioner.

3. Based on the testimony of the president of petitioner's Board of Directors, petitioner under the employment contract intended that all of its earnings in excess of amounts necessary for its operation, planned expansion and reserves, were to be distributed to its stockholder physicians, and, therefore, the employment contract provides not only a method of computation for services, but also a method for distribution of profits to stockholders.

How does respondent answer petitioner's contention that the subsidiary findings and conclusions of the Tax Court are erroneous and do not support its ultimate conclusion? Respondent practically ignored the subsidiary findings and conclusions of the Tax Court set forth above. Nowhere does respondent attempt to support the Tax Court's finding that the employment contract is

ambiguous. Neither does respondent expressly mention the Tax Court's holdings that under the employment contract the doctors had obligated themselves to render services to petitioner for fees equal to those set forth in the base fee schedule, or that the contract does not require or provide for payments of compensation to doctors in excess of the base fees set forth in the fee schedule. Perhaps respondent recognizes that whether the contract is ambiguous constitutes a question of law which this Court may determine as well as the Tax Court, or that respondent's stipulation as to the clear meaning of the contract (Tr. 59) conflicts with any finding of ambiguity.

No mention can be found in respondent's brief of the Tax Court's finding and conclusion set forth in Paragraph 3. above.

**e. Independent arguments of respondent
do not support ultimate finding
and conclusion of Tax Court.**

Rather than attempting to substantiate the subsidiary findings and conclusions actually made by the Tax Court, respondent attempts to support the ultimate finding and conclusion (that payments in excess of base fees were profit distributions rather than compensation) through independent argument hereinafter reviewed. The appropriateness of such arguments seems subject to question. The ultimate finding and conclusion of the Tax Court must stand or fall on the basis of the subsidiary findings and conclusions actually made by the Tax Court, not on respondent's version of what

the Tax Court should or could have specified as the basis for its ultimate finding and conclusion.

As before mentioned, the respondent makes no reference whatsoever to the Tax Court's holding that the employment contract is ambiguous. Neither does respondent support the interpretation of the employment contract made by the Tax Court. Rather, respondent points to several factors which he contends indicate that the fees set forth in the fee schedule were "* * * intended to compensate the member physicians for the services (Br. 16) * * * intended to be of a compensatory nature (Br. 16) * * * intended to be fully compensatory for the services rendered (Br. 18)." Even if the factors cited by respondent actually indicated that the fees set forth in the fee schedule were intended to be compensatory for the services rendered, respondent fails to explain exactly how this promotes the conclusion that the payments in excess of base fees were distributions of profits in view of the fact that the employment contract requires payments to physicians in accordance with the formula under the contract (undenied by respondent), which formula may generate full compensation in excess of the base fees as was the case in the subject years.

Two of the factors cited by respondent in support of the ultimate conclusion of the Tax Court are factors (a) and (b) set forth above under paragraph 2 of petitioner's outline of the Tax Court's subsidiary findings and conclusions. In regard to (a),—that the contracts by which petitioner sells its services to subscribers provide that member physicians accept K.M.S.B. fees as

payment in full for services to subscribers,—respondent makes the same unwarranted assumption as the Tax Court that the reference to “K.M.S.B. fees” means the fees set forth in the fee schedule rather than the full amount of compensation generated by the formula under paragraph 3 of the employment contract. Elsewhere in the contracts with subscribers where reference is definitely made to the fees specified in the fee schedule, the contracts use the term “fee schedule.” An example of this is the provision in the contracts with subscribers for payments to non-member doctors for emergency care referred to by respondent at page 17 of his brief. Where the contract with subscribers provides for payment to non-member physicians, the reference is to the “fee schedule,” while the before-mentioned reference to payments to member doctors is “K.M.S.B. fees.” The difference in terminology would indicate a difference in meaning. Obviously, “K.M.S.B. fees” payable to member physicians means the full compensation payable pursuant to formula under paragraph 3 of the employment contract with each physician, while payments in accordance with the “fee schedule” to non-member doctors means the fixed fee specified in the fee schedule.

The foregoing furnishes the obvious answer to respondent’s argument that because non-member doctors outside Klamath County receive payments from petitioner only to the extent of the fees set forth in the “fee schedule,” the fee schedule was “intended to be fully compensatory for the services rendered” (Br. 17 and 18). This provision of the contracts with subscribers is a limitation upon the liability of petitioner to pay non-

member doctors who have no contracts with petitioner requiring them to accept the fees generated under the employment contract. There is no evidence that the non-member doctors accepted the fees set forth in the fee schedule as full compensation, or that petitioner intended the payments as such. The inference is quite to the contrary.

Respondent merely mentions as “noteworthy” (Br. 17) fact (b) mentioned above,—that in determining book value of petitioner’s stock, 100 per cent of base fee billings were treated as Accounts Payable by petitioner. The treatment of base fees as accounts payable for the limited purpose of determining book value of petitioner’s stock when such stock is transferred by the physicians, can in no way be interpreted as an indication that the physicians intended the fees specified in the base fee schedule to constitute full compensation. When a physician transfers stock of petitioner, he is terminating his relationships with the petitioner and what might be provided for purposes of determining the value of its stock upon such termination has no relationship to what the doctors agree to accept as full compensation for services rendered. Furthermore, this provision is perfectly logical when its function is explored.³

³ Accounts payable for services rendered will only exist when the book value of the stock is being determined during the six month intervals between computation and payment of the full compensation. The full compensation is not accruable under any sound accounting principles until determined at the six month intervals, and immediately upon determination that contract requires the payment of the amount so determined to the physicians. Therefore, no Accounts Payable exist for any appreciable time for the full compensation generated by the employment contract.

The other factors cited by respondent as purportedly indicating that the base fees were intended to be fully compensatory are not mentioned by the Tax Court as forming the basis for its findings and conclusions. Respondent refers to the requirement under the employment contract that the minimum fees may not be reduced without the prior notice. The proper inference to be drawn from this provision is quite the opposite of respondent's contention that the minimum fees or base fees are intended to be fully compensatory. Would it be logical for the doctors to permit the minimum fees to be reduced by merely giving prior notice if such minimum fees were intended as "compensation for services rendered"? The fact that the base fees may be reduced without the consent of the contracting doctors merely by giving prior notice is positive evidence that such base fees were not intended as full compensation but were merely the basis upon which full compensation is to be computed under the formula set forth in the employment contract.

Respondent contends (Br. 16) that evidence of the

However, during the six month intervals between determinations of the full compensation, there is a liability for the services rendered although the exact amount of such liability cannot be determined until the computation at the end of the six month period. How should such undetermined liability be set up on the books of petitioner for purposes of determining book value of the stock, or for any other purposes? The most logical answer is to set up Accounts Payable in the amount of the base fees specified in the fee schedule. This is the best that can be done under the circumstances where the actual amount of the compensation is unknown, and such furnishes no indication whatsoever that the doctors intended the fees in the fee schedule to constitute full compensation, or that the doctors agree to accept the fees in the fee schedule as full compensation.

intended compensatory nature of the base fees is afforded by the increase in the fees specified in the fee schedule effective during the years in question over the original fee schedule effective January 2, 1940. Any such interpretation is precluded by the fact that a uniform increase in the base fees has no effect upon the compensation generated by the formula in the employment contract. Petitioner again makes reference to the finding of the Tax Court that the fee schedule "was used for the purpose of differentiating between medical and surgical procedures and to insure member physicians would receive a like compensation for such services" (Tr. 28 and 29). The Tax Court attaches no such significance as is advanced by respondent to the change in the fee schedule.

At pages 18 and 19 in his brief, respondent seems to attribute some adverse consequence to the fact that under the formula in the employment contract, the percentage of profits payable as full compensation is not determined until after the amount of the profits has been ascertained. Under the employment contract petitioner is obligated to pay to the doctors (in proportion to base fee billings) the net income of petitioner remaining after deducting such amounts as the Board of Directors determines should be retained for corporate purposes. The amount retained for corporate purposes, of course, affects the amount to be distributed as compensation, so the exact amount payable under the formula is not determined until after the profits have been ascertained. From this, respondent would infer that petitioner may use the formula under the employment contract as a

devious device for distributing all profits. Petitioner paid substantial income taxes during the years in question (Ex. G, Tr. 150). Under the employment contract petitioner is authorized to deduct such amounts as the Board of Directors determines should be retained for corporate purposes. There is no evidence whatsoever that the exercise of such authority by the Board of Directors was motivated by tax considerations. The possibility of tax abuse is all conjecture on the part of respondent. A discussion of this issue is contained in Mertens, Law of Federal Income Taxation (rev. ed., 1954) at Sec. 25.78 wherein the author cites the *Am-Plus Storage Battery Co.* case, *supra*, and other authorities and concludes “* * * The guiding principle in each case is whether the total compensation properly measures the value of the services of the recipient of the compensation as distinguished from the capital contribution which he makes as a stockholder.” This test is conclusively answered in the instant case by the fact that the payments to the doctors were in direct proportion to services actually rendered and disproportionate to stockholdings.

Not only does respondent advance arguments in his brief not mentioned by the Tax Court as the basis of its findings and conclusions, but on pages 20 and 21 respondent asserts facts contrary to those found by the Tax Court. Respondent claims that some of petitioner's income derived from the operation of the hospital facilities was not due to the efforts of the doctors. As found by the Tax Court,

"It is not true either that the doctors did not render services to the hospital. In a very real sense, but for the services they rendered to hospital patients, there would have been little, if any, hospital income." (Tr. 42).

In any event, there are many instances (which may be the rule rather than the exception) where the recipient of compensation based on profits cannot point to the fact that the income of the employer is derived exclusively from the direct result of his personal services.⁴

f. Restatement of petitioner's basic contention.

Respondent states (Br. 20) that a holding of compensation is not required by the fact the taxpayer and the physicians consistently referred to the payments in its corporate actions as compensation. Also, respondent claims that the lack of correlation between the payments and the stock holdings of the recipients is not determinative of the issue. Respondent misses the point of petitioner's basic argument. Petitioner has never contended that any one factor in and of itself is determinative of the issue. Rather, petitioner's contention is based upon the combination of all three factors set forth above. It is the impact of the three factors in combination which petitioner claims is determinative of the

⁴ In the case of an executive officer of a manufacturing corporation, there are numerous elements other than the personal services of the executive which account for the income of the employer upon which the percentage compensation arrangement of the executive may be based. In the instant case, there is a much greater correlation between the payments to the physicians and the income of petitioner than usually exists in the ordinary situation of compensation based on profits.

issue. Where payments purportedly made as compensation, are in direct proportion to services actually rendered, and are not in proportion (but are disproportionate) to stock holdings, then the payments constitute compensation for the services rendered rather than profit distributions upon stock. Neither the Tax Court, nor respondent in his brief, recognizes the combined impact of these three factors. Although the Tax Court's findings of fact acknowledge the existence of the three factors, the opinion of the Court does not mention the possibility that the combined existence of such three factors may have a bearing upon the issue.

Instead of phrasing petitioner's basic proposition in terms of positive factors, the existence of which dictates the conclusion that the subject payments are compensation rather than profit distributions, petitioner's proposition may be expressed in terms of negative elements which must exist singly or in combination to warrant consideration of payments as profit distributions rather than compensation. No case discovered by petitioner, and none cited by respondent, substantiates the Commissioner's disallowance of compensation on the grounds that the disallowed portion constituted non-deductible profit distributions, unless one or more of the following factors were present:

- (1) The parties called the payments profit distributions, or at least did not expressly refer to the payments as compensation.

- (2) The payments in question were not made in direct proportion to services actually rendered.

(3) The payments were in proportion to the stock holdings of the recipients.

(4) The payments were unreasonable in relation to the actual value of the services rendered.

It is petitioner's understanding of the applicable cases that at least one of the above mentioned factors must be present before payments claimed as compensation deductions can be disallowed as profit distributions. In the instant case, none of the above adverse factors is present to support the Tax Court's ultimate finding and conclusion that the payments in excess of base fees were profit distributions rather than compensation. No other factors have, or logically can, support the ultimate finding of the Tax Court and thus such finding must fall.

g. Compliance with independent requirement of reasonableness.

The Tax Court was required to pass upon the reasonableness of the payments to the physicians because of respondent's contention that even a portion of the payments equal to base fees were unreasonable. Since the reasonableness of the payments in excess of base fees was immaterial in view of the Tax Court's conclusion that such payments were profit distributions rather than compensation, the extent of the finding as to reasonableness might have been limited to the base fees if evidence restricted to payments equal to base fees had been available and if the Tax Court had chosen to rely on such evidence.

Regardless of how the Tax Court *might* have passed

upon the reasonableness of the base fees, it *actually* grounded its finding upon the testimony of the physicians concerning which the Tax Court unequivocally states (Tr. 43): “* * * This testimony remains uncontradicted upon the record and we see no reason to give it less than its full weight.” Such uncontradicted testimony accorded full weight was directed to the total amounts paid under the employment contracts, not just the amounts equal to base fees. In fact, such testimony expressly refuted the assertion that anything less than the full amount paid under the employment contract was reasonable. When full weight is given to uncontradicted testimony, the facts established thereby include the fact to which the testimony is directed, not merely some lesser facts encompassed therein even though such lesser facts may be the only ones pertinent to the issue then being decided. No logical basis exists for giving effect to the testimony of the physicians up to 100% of base fees and then disregarding same for the payments in excess of base fees. Consequently, the before-mentioned finding of the Tax Court constituted a finding of reasonableness for the full amounts paid under the employment contracts, or at least such a finding is mandatory under the circumstances.

Furthermore, where there are sound economic reasons for a compensation arrangement based on profits, the amount of compensation generated the reunder is deductible even though such amount may prove to be greater than what might otherwise be paid. This is the clear import of Paragraphs (2) and (3) of the regulation quoted on pages 4 and 5 of respondent's brief. The only

limitations contained in this regulation dealing with contingent compensation is that “* * * the compensation paid may not exceed what is reasonable under all the circumstances.” The circumstances to be considered include the fact that the formula under the employment contract could generate compensation less than base fees, as well as compensation in excess of base fees, and that such compensation arrangement was the only feasible method by which petitioner could meet the economic necessities of the situation.

Respectfully submitted,

MAUTZ, SOUTHER, SPAULDING,
DENECKE & KINSEY,

by.....



No. 16025

United States
COURT OF APPEALS
for the Ninth Circuit

KLAMATH MEDICAL SERVICE BUREAU,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING

Appeal from the Tax Court of the United States

MAUTZ, SOUTHER, SPAULDING, DENECKE & KINSEY,
WILLIAM H. KINSEY,
JAMES R. MOORE,

1001 Board of Trade Building,
Portland 4, Oregon,

Attorneys for Petitioner.

FILED

JAN 14 1959

PAUL P. O'BRIEN, CLERK



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Mertens, Law of Federal Income Taxation (Rev. ed., 1954), Vol. 4, Sec. 25.64	5-6
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No. 16025

United States
COURT OF APPEALS
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KLAMATH MEDICAL SERVICE BUREAU,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING

Appeal from the Tax Court of the United States

TO THE HONORABLE ALBERT LEE STEPHENS,
CHIEF JUDGE, and HOMER T. BONE and
STANLEY N. BARNES, CIRCUIT JUDGES,
CONSTITUTING THE COURT IN THE ORIGINAL
HEARING HEREIN:

With reluctance because of the known burdens carried by this Court, but with the firm and sincere conviction that the opinion of this Court is contrary to and an extension of existing tax law, petitioner, Klamath Medical Service Bureau, respectfully requests that a rehearing be granted and the opinion rendered herein be reconsidered and set aside.

Petitioner came to this Court asserting that a decision rendered by the Tax Court of the United States holding that certain payments to stockholder employees were distributions of profits was erroneous.

Two grounds are set forth by this Court as the basis for its opinion. In affirming the Tax Court, this Court held (1) that the ultimate finding of fact of the Tax Court was not clearly erroneous; and (2) that the payments here in question were not "necessary" as required by Section 23 (a) of the Internal Revenue Code of 1939, since they were in addition to amounts required to be paid under the contracts of employment.

The second ground of this Court's opinion will be further considered below. However, it should be pointed out that this portion of the opinion is contrary to the authorities cited in Respondent's letter dated December 30, 1958, addressed to the Clerk of this Court, which stated that the Judges who participated in the case might wish to reconsider the wording of the opinion in regard to this second ground. A copy of this letter of Respondent is attached to this Petition as an appendix. Since Respondent joins in questioning this Court's expression of its second ground, it seems appropriate for this Court to not only reconsider the second ground, but also to determine whether the conclusion reached can be supported by the "not clearly erroneous" rule alone.

It is and has been Petitioner's contention that the major issue to be determined is not a question of fact. The question may best be phrased: Did the Tax Court

employ the proper criteria under the statute and regulations for ascertaining whether the purported compensation was, in fact, a distribution of profits. *This is a question of law.* *Collins v. C.I.R.*, 216 Fed 2d 519 (CA 1st, 1954); *Hoffman Radio Corporation v. C.I.R.*, 177 Fed 2d 264 (CA 9th, 1949); *Mayson Manufacturing Co. v. C.I.R.*, 178 Fed 2d 115 (CA 6th, 1949); *Zanuck v. C.I.R.*, 149 Fed 2d 714 (CA 9th, 1945), and *Maytag v. C.I.R.*, 187 Fed 2d 962 (CA 10th, 1951).

It is "clearly erroneous" as a matter of law for the trier of the fact to refuse to employ the correct criteria, *Mayson Mfg. Co. v. C.I.R.*, *supra*, or to employ the "wrong or insufficient criteria or criterion," *Maytag v. C.I.R.*, *supra*, in arriving at its determination of a question of fact.

Petitioner asserts that the Tax Court did not properly consider four well established criteria in reaching its decision and instead employed criteria which cannot support its determination. In the alternative, it is submitted that none of the facts upon which Respondent relies can be considered substantial in resolving the issue to be determined, and, at the very least, the clear weight of the evidence is in favor of Petitioner. Compare *Mayson Mfg. Co. v. C.I.R.*, *supra*, at p. 119.

The principal argument of petitioner on appeal was that the findings of the Tax Court established all of the elements necessary to require a holding that the payments made to employee stockholders of Petitioner were compensation. The opinion of this Court confirms that Petitioner established: (a) the total amounts paid

were characterized as compensation for personal services actually rendered; (b) the payments were in proportion to the services rendered; (c) the payments were disproportionate to stockholdings; and (d) the payments were reasonable in amount.

All of the authorities to date have used the existence or nonexistence of one or more of these criteria in determining whether amounts paid as compensation were in fact dividends. See, for example, *Ox Fibre Brush Co. v. Blair*, 32 Fed 2d 42 (CCA 4th, 1929), where the Court emphasized the fact that the board of directors characterized the payments as compensation; *Am-Plus Storage Battery Co. v. C.I.R.*, 35 Fed 2d 167 (CCA 7th, 1929), where the principal issue was considered to be reasonableness; *Heil Beauty Supplies v. C.I.R.*, 199 Fed 2d 193 (CA 8th, 1952), where the primary consideration was the failure of the employee to render services in proportion to the amounts received; and *Long Island Drug Co., Inc.*, 35 BTA 328, affirmed 111 Fed 2d 593 (CCA 2d, 1940), cert. denied 311 U.S. 680, where payments in proportion to stock ownership was stressed. No case discovered by Petitioner and no case cited by the Tax Court or Respondent has held that payments were distributions of profits where all of the above facts were established in favor of a taxpayer. The requirements set forth in Treasury Regulation 118, Sec. 39.23 (a)—6 of the Internal Revenue Code of 1939 are substantially the same as have been found in favor of Petitioner. The case of *Am-Plus Storage Battery Co. v. C.I.R.*, supra, cited in the opinion of this Court uses the same criteria as those listed in the Treasury Regu-

lation. The decision of the Court was in favor of the Commissioner on the same issue as is here involved because the Commissioner established that the amounts paid as purported compensation were unreasonable and were in proportion to the stockholdings. The opinion of the Seventh Circuit states:

“Hence, the real question here is whether Petitioner met the burden on it of showing that the allowances made and deducted were reasonable, leaving no substantial basis for the Board to arrive at the contrary conclusion.”

The failure of the Tax Court to apply these criteria which were affirmatively established by the Petitioner is error as a matter of law, unless there are additional criteria to be applied which Respondent has established, and such criteria constitute substantial evidence.

What are the facts asserted by the Respondent, and do such facts constitute valid criteria in support of the ultimate finding of the Tax Court? The arguments of Respondent and the facts upon which he relies are set forth on pages 7 and 8 of the opinion of this Court. They will be individually examined.

Respondent argues that the compensation arrangement of Petitioner could result in all income being paid out as compensation. Assuming the truth of such an assertion, what possibly probative value can such a “fact” have in determining whether the payments are compensation or dividends in the years here involved? Perhaps this is one of the facts the existence of which invites “careful scrutiny” of a compensation arrangement, see 4 *Mertens, Law of Federal Income Taxation*, Section

25.64 (Rev. ed., 1954), at page 156, but it certainly is not true that every taxpayer who may have a loss for tax purposes has distributed profits under the guise of compensation. Certainly for the years under review, such an argument is not well taken, since in each of the years in question the Petitioner had substantial profits and paid income taxes (Tr. 15-20).

Respondent also argues that some of the compensation paid was from income not attributable to the services of the employee-doctors. Upon oral argument, much of the time allocated was spent upon an examination of this contention. Such an examination was unnecessary, and it is unfortunate the Petitioner neglected to point out the portions of the transcript set forth below. The assertion of Respondent in this regard is simply untrue and was not established by the Tax Court findings. This argument was initially advanced as the basis for the deficiency assessed (Tr. 121), but was rejected by the Tax Court which found (Tr. 42):

“ * * * It is not true either that the doctors did not render services to the hospitals. In a very real sense, but for the services they rendered to hospital patients, there would have been little, if any, hospital income. It is reasonable to conclude Petitioner would otherwise have been unable to utilize hospital facilities and would not have acquired them.”

In addition, the doctors managed the hospitals and the other facilities of the Petitioner without compensation other than the amounts here under consideration (Tr. 59, 128-130).

That the fee schedule was raised several times is said to indicate that the fees listed represented the full amount of compensation payable to the doctors. In light of the corporate resolutions authorizing the total payments and the clear language of the employment contract, it is doubtful whether such an inference should be drawn. But assuming that there existed no contractual duty to pay more than the fees listed in the fee schedule, it does not follow that the payments in excess of the amounts so listed were distributions of the profits. This will be discussed below in considering the second ground of this Court's opinion.

Finally, the Court below found that the fees listed in the fee schedule of Petitioner constituted reasonable compensation. With this proposition there can be no quarrel. The Court below gave "full weight" to the testimony that the entire amounts paid were reasonable (Tr. 43), so, of course, any lesser sums would satisfy the "reasonable" requirement of the statute. But, again, what probative value does such a finding have on the issue of whether the total payments made were or were not compensation?

The Tax Court's determination of the question of fact here in issue must be based upon the application of one or more criterion sufficient to support its finding. In view of this Court's confirmation of Petitioner's compliance with four traditional and recognized criteria for determining whether particular payments constitute dividends or compensation, the determination of the Tax Court must not only be based upon a new and independent criterion, but such criterion must constitute

substantial evidence sufficient to counteract or nullify the four factors established by Petitioner. It is submitted that upon examination the arguments of Respondent and the facts relating thereto do not establish any such independent criterion, much less a criterion which can be labeled as substantial evidence.

It is submitted that to increase the burden on this taxpayer, or any taxpayer, by holding that the "facts" asserted by Respondent must be negatived in order to show that payments in fact were compensation, is to unnecessarily narrow the definition of "compensation" as the term is used in the statute; and to approve the argument of Respondent is to allow the Tax Court to make a finding "of fact" that payments to stockholder employees are distributions of profits any time a compensation plan based on profits *might* in the future result in the employer having no taxable income.

As a part of the second ground for its opinion, this Court accepts the conclusion of the Tax Court that the employment contract is ambiguous and authorizes the payment of only 100% of the base fees as compensation. Whether or not the contract is ambiguous is a legal question and can be determined by this Court as well as the Tax Court. *Quon v. Niagara Fire Insurance Co. of New York*, 190 Fed 2d 257 (CA 9th, 1951), and *Anzano v. Metropolitan Life Insurance Co. of New York*, 118 Fed 2d 430 (CCA 3rd, 1941). In light of the stipulation of the parties (Tr. 53-54) and the clear wording of the employment contract (Ex. 23, Tr. 105) Petitioner asserts that such a conclusion is clearly error. However, again assuming that such a conclusion is correct, it

establishes no basis for a holding that the payments in excess of the base fees were not "necessary." It is well settled that amounts paid for services rendered are deductible as compensation even though such payments were not made pursuant to the enforceable legal obligation. Indeed, any valid business purpose constitutes compliance with the "necessary" requirement of the statute. See for example the Treasury Regulation set forth below relating to bonuses and the cases cited in Respondent's letter, and compare *Dunn & McCarthy, Inc. v. C.I.R.*, 139 Fed 2d 242 (CA 2d, 1943). There is no dispute that the Petitioner paid the sums here in question pursuant to the authority of corporate resolutions authorizing the total payments as fees. Treasury Regulation (1939 Code) 118, Section 39.34 (a)—8, which is the same as Section 1.162-9 of the 1954 Code Regulations cited in Respondent's letter, reads as follows:

"Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income."

In conclusion, it is submitted that the facts found by the Tax Court upon which Respondent relies do not and cannot logically constitute the proper criteria upon which to base a holding that amounts paid to stock-

holder-employees as compensation are dividends. To so hold is to go beyond the existing cases and to open up a vast area within which the Internal Revenue Service may disallow purported compensation payments which would otherwise be unquestioned as legitimate business expenses if it were not for the fact that they were paid pursuant to a plan based upon a percentage of profits.

In addition, this Court's holding that a portion of the payments were not "necessary" because voluntary is not supported by the existing cases and the Treasury Regulation on the subject.

The questions to be decided by this court are primarily questions of law, and the credibility of witnesses is not involved. Under such circumstances this Court may reexamine the decision of the Tax Court and substitute its own conclusion based upon the record.

WHEREFORE Petitioner respectfully petitions this Court for a rehearing herein and that this case be reconsidered and the decision of the Tax Court reversed.

Respectfully submitted,

MAUTZ, SOUTHER, SPAULDING,
DENECKE & KINSEY,

By JAMES R. MOORE,
Attorneys for Petitioner.

STATE OF OREGON)
) ss
County of Multnomah)

I, James R. Moore, of attorneys for Petitioner do hereby certify that the foregoing petition for rehearing is well founded in my judgment and is not interposed for the purposes of delay.

JAMES R. MOORE.



APPENDIX

December 30, 1958

CKR:LAJ:HAB:mo'b
5-9943

AIR MAIL

Mr. Paul P. O'Brien
Clerk

United States Court of Appeals
for the Ninth Circuit
San Francisco, California

Re: Klamath Medical Service Bureau
v. Commissioner (C. A. 9th—No. 16,025)

Dear Mr. O'Brien:

This office has received the opinion of the Court dated December 15, 1958, affirming the Tax Court decision in the above-entitled case in favor of the Commissioner. We have been somewhat concerned as to the possibility of language employed in the next to last paragraph in this opinion being seized upon and read out of context as conflicting with the well-established principle that amounts paid as compensation for services rendered constitute income to the recipient even though such payments were not made pursuant to an enforceable legal obligation. See, e.g., *Botchford v. Commissioner*, 81 F. 2d 914 (C.A. 9th); *Nickelsburg v. Commissioner*, 154 F. 2d 70 (C. A. 2d); *Davis v. Commissioner*, 81 F. 2d 137 (C.A. 6th); *Roberts v. Commissioner*, 176 F. 2d 221 (C.A. 9th), and see also Treasury Regulations (1954 Code), Section 1.162-9; *Bateman v. Commissioner*, 34 B.T.A. 351.

It is our belief that the Court did not intend such a construction to be placed upon its opinion and that the judges who participated in the case might wish to reconsider the wording of this paragraph in the light of this comment.

Sincerely yours,

CHARLES K. RICE
Assistant Attorney General
Tax Division

By: LEE A. JACKSON
Chief, Appellate Section

CC: James R. Moore and
William H. Kinsey, Esquires
Mautz, Souther, Spaulding, Denecke and Kinsey
1001 Board of Trade Bldg.,
Portland, Oregon

No. 16031 ✓

United States
Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
vs.

EARL R. WILKINSON and GRAYCE WIL-
KINSON, Respondents.

Transcript of Record

Petition to Review a Decision of The Tax
Court of the United States

FILED

AUG -- 4 1958

PAUL P. O'BRIEN, CLERK



No. 16031

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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The Tax Court of the United States

Docket No. 61977

EARL R. WILKINSON and GRAYCE WILKINSON,
Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1956

Apr. 25—Petition received and filed. Taxpayer notified. Fee paid.

Apr. 25—Copy of petition served on General Counsel. Served 4/27/56.

Jun. 20—Answer filed by Respondent.

Jun. 20—Request for hearing in Portland, Oregon
filed by respondent. 6/21/56—Granted.

Nov. 26—Hearing set Feb. 18, 1957, Portland, Oregon.

Nov. 29—Motion to place case on the next Portland, Oregon calendar, filed by petitioner.
11/29/56 Granted to 2/18/57.

Nov. 30—Motion of Nov. 29 served.

1957

Feb. 4—Hearing set Feb. 19, 1957—Portland, Oregon—revised as to trial date.

Feb. 19—Trial had before Judge Withey on respondent's motion to file amended answer — Granted — Stipulation of Facts. Respondent's motion (served) and amended answer (served) filed at hearing. Briefs due 4/22/57; Replies due 5/22/57.

4 *Commissioner of Internal Revenue vs.*

1957

Mar. 11—Brief filed by petitioner. Served 6/21/57.

Apr. 8—Transcript of Hearing 2/19/57 filed.

Apr. 18—Motion for extension of time to June 10, 1957 to file brief, filed by Respondent. Granted 4/22/57. Served 4/25/57.

Jun. 10—Motion for extension of time to June 21, 1957 to file brief, filed by respondent. 6/11/57—Granted. Served 6/14/57.

Jun. 20—Brief for respondent filed. Served 6/21/57.

July 8—Reply brief filed by petitioner. Served 7/23/57.

Sep. 5—Reassigned from Judge Withey to Judge Mulroney.

Dec. 6—Opinion filed. Judge Mulroney. Decision will be entered for the petitioners. Served 12/6/57.

Dec. 6—Decision entered, Judge Mulroney. Served 12/10/57.

1958

Mar. 3—Petition for review by U. S. Court of Appeals, 9th Circuit filed by respondent.

Mar. 27—Respondent's motion to extend time for filing record on review and docketing petition for review to June 1, 1958.

Mar. 27—Order extending time for filing record on review and docketing petition for review to June 1, 1958, entered.

May 13—Proof of service of petition for review filed. (Counsel.)

1958

May 13—Proof of service of petition for review filed. (Taxpayers.)

May 13—Statement of Points with proof of service thereon.

May 13—Designation of contents of record on review with proof of service thereon, filed.

[Title of Tax Court and Cause.]

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (A:R:90D:ENH:ew) dated March 14, 1956, and as a basis of their proceeding allege as follows:

(1) The petitioners are individuals and are husband and wife, with residence at 4535 S.W. 78th Avenue, Portland 1, Oregon. The return for the period here involved was a joint return and was filed with the District Director of Internal Revenue for the district of Portland, Oregon.

(2) The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioners on March 14, 1956.

(3) The deficiency as determined by the Commissioner is in income taxes for the calendar year 1953 in the amount of \$109.38, all of which is in dispute.

(4) The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in determining that

the reorganization whereunder the First National Bank of Portland created a trust and transferred thereto its holdings of the capital stock of First Securities Company, constituted a dividend distribution to the stockholders of said Bank.

(b) The Commissioner erred in determining that said reorganization transaction constituted a dividend distribution of First Securities Company stock, in kind, by the First National Bank of Portland to its stockholders.

(c) The Commissioner erred in determining that the Petitioners received stock of First Securities Company from the First National Bank of Portland.

(d) The Commissioner erred in determining that the Petitioners received any dividend distributions from the First National Bank of Portland in 1953 in excess of the cash dividends of \$1,764.80.

(e) The Commissioner erred in determining that the fair market value of all the outstanding capital stock of the First Securities Company on January 20, 1953 was \$350,000.

(f) The Commissioner erred in failing to determine that the said reorganization transaction was non-taxable within the provisions of Section 112 (b)(11) of the Internal Revenue Code of 1939.

(g) The Commissioner erred in failing to determine that the said reorganization transaction was non-taxable within the provisions of Section 112 (g)(1)E or Section 112(g)(1)(F) of the Internal Revenue Code of 1939.

(h) The Commissioner erred in failing to determine that the beneficial interests in First Securities Company stock had no fair market value on January 20, 1953.

(i) The Commissioner erred in failing to determine that the stock of First Securities Company had no fair market value on January 20, 1953.

(5) The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) On January 20, 1953 petitioners were the owners of 1,103 shares of the outstanding capital stock of The First National Bank of Portland.

(b) The First National Bank of Portland is a national banking association with principal office located in Portland, Oregon. On January 20, 1953 it had 1,200,000 shares of its capital stock outstanding.

(c) On January 20, 1953 and for several years prior thereto, The First National Bank of Portland was the owner of all the outstanding capital stock of First Securities Company.

(d) First Securities Company is an Oregon corporation with principal office in Portland, Oregon. The business of First Securities Company consisted of assisting the said Bank by performing certain functions in behalf of said Bank and also of making of investments in various types of property. On January 20, 1953 First Securities Company had 500 shares of its capital stock outstanding.

(e) Prior to January 20, 1953 the United States Comptroller of the Currency had expressed criti-

cism of the ownership of the stock of said First Securities Company by said First National Bank of Portland.

(f) In order to satisfy the criticism of the said Comptroller of the Currency the said First National Bank of Portland proposed a reorganization plan whereby:

1. It would create a trust with its own officers as trustees, to be administered for the benefit of all of its shareholders, ratably in the same proportions as they shall from time to time own of record stock of the Bank, and

2. It would transfer the said stock of First Securities Company to said Trust.

(g) On January 20, 1953 the said reorganization plan was approved by the stockholders of the said First National Bank of Portland.

(h) On January 20, 1953 the said reorganization plan was made effective by action of the Board of Directors of said First National Bank of Portland. On said day the said Bank created the Trust as required by said reorganization plan. On said day the said Bank transferred to said trust all of the 500 outstanding shares of the capital stock of First Securities Company.

(i) No certificates or other papers were distributed to the stockholders of said Bank evidencing their beneficial interest in the stock of the First Securities Company and nothing was received by them with respect to said beneficial interest which could be disposed of by them separately from the

stock of the First National Bank of Portland owned by them. No notation was made upon, or appears upon, the Bank stock certificate to indicate that the certificate also represented a beneficial interest in the stock of said Company.

(j) Under and by virtue of said reorganization plan the stock of the said First National Bank of Portland and the beneficial interests in the First Securities Company stock may not be transferred separately; and if and when any shares of stock of the said Bank are transferred the pro rata interest of the stockholders of the said Bank in the stock of the said Company, to the extent of the shares so transferred, will automatically be transferred along with the transfer of the Bank stock without the execution of any separate papers.

(k) The Respondent has determined that under the said reorganization plan the petitioners received on January 20, 1953 a dividend in kind measured by the fair market value of the First Securities Company stock on that date, and determined further that the value of said dividend was \$321.71.

(l) The Respondent erred in determining that petitioners received First Securities Company stock, and erred further in determining that Petitioner received a dividend of any amount as the result of the said reorganization plan, or received a dividend at all in the said reorganization transaction.

(m) The beneficial interests in the First Securities Company stock had no fair market value on January 20, 1953.

(n) Petitioners received nothing of value as the result of the said reorganization transaction on January 20, 1953. Petitioners' proprietary position as a stockholder of the said First National Bank of Portland, and the value thereof, remained the same after the said reorganization transaction as before. Said reorganization transaction effected a mere change of form in the relationship between The First National Bank of Portland and the First Securities Company, and was merely a form of recapitalization of The First National Bank of Portland, and did not sever the petitioners' unit investment in the said Bank and the said Company.

(o) Respondent has determined that "there has been no trading in the stock of the First Securities Company, and no actual market value has been established" and thereupon determined that "an adjusted book value has been used to establish the value at the date of distribution" to be \$350,000.00.

(p) The Respondent erred in determining that the said outstanding stock of First Securities Company had a fair market value of \$350,000 on January 20, 1953. Said stock had no fair market value on January 20, 1953.

Wherefore, the Petitioner prays that the Court may hear the proceeding and eliminate the proposed deficiency and for such other and further relief as the Court may deem proper.

/s/ GEORGE H. KOSTER,
Counsel for Petitioner.

Duly Verified.

EXHIBIT "A"

(Copy)

U. S. Treasury Department
Internal Revenue Service
District Director
830 N. E. Holladay Street
Portland 14, Oregon

March 14, 1956

In replying refer to:

A:R:90D:ENH:ew

Mr. Earl R. Wilkinson and
Mrs. Grayce Wilkinson
Husband and Wife
4535 S. W. 78th Avenue
Portland 1, Oregon

Dear Mr. and Mrs. Wilkinson:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1953 disclosed a deficiency of \$109.38 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days, you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Colum-

Exhibit "A"—(Continued)

bia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to District Director of Internal Revenue, Chief, Audit Division, 830 N.E. Holladay Street, Portland 14, Oregon. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

RUSSELL C. HARRINGTON,
Commissioner,

By /s/ R. C. GRANQUIST,
R. C. Granquist,
District Director.

Enclosures:

Statement

Form 160

Agreement Form

1230-A.

Exhibit "A"—(Continued)

STATEMENT

Mr. Earl R. Wilkinson and Mrs. Grayce Wilkinson

Husband and Wife

4535 S. W. 78th Avenue

Portland 1, Oregon

Tax liability for the taxable year ended December 31, 1953.

	Deficiency
Income tax	\$109.38

This determination of your income tax liability has been made upon the basis of information on file with the Internal Revenue Service.

Adjustments to Income

Net income as disclosed by return.....	\$14,815.30
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Unallowable deductions and additional income:

(a) Dividends	321.71
---------------------	--------

\$15,137.01

Explanation of Adjustments

(a) It has been determined that the dividends paid in 1953 by The First National Bank of Portland, Oregon, in stock of the First Securities Company constituted a taxable dividend computed as follows:

Dividends paid in cash	\$1.60	per share
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Dividend paid in stock of First Securities Co.29167	per share
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Total dividends paid in 1953	\$1.89167	per share
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Since you owned 1103 shares your taxable dividend is determined to be:

1103 shares x \$1.89167	\$2,086.51	
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Less reported in your return	1,764.80	
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Increase in taxable dividend of	\$ 321.71	
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Computation of Tax

Net income as adjusted	\$15,137.01
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Less: Exemption 3 x \$600.00	1,800.00
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Income subject to tax	\$13,337.01
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Exhibit "A"—(Continued)

Income tax liability	\$3,486.58
Income tax liability disclosed by return	3,377.20

Deficiency of income tax	\$ 109.38
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Served and Entered April 27, 1956.

[Endorsed]: T.C.U.S. Filed April 25, 1956.

[Title of Tax Court and Cause.]

ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contains in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that he erred in his determination of the deficiency in income tax as shown by the notice of deficiency from which the appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph 4(a) to (i), inclusive, of the petition.

5. (a) Admits the allegations contained in paragraph 5(a) of the petition.

(b) Admits the allegations contained in the first sentence, ending with the words "Portland, Oregon", of paragraph 5(b) of the petition. For lack

of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in said subparagraph.

(c) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(c) of the petition.

(d) Admits the allegations contained in the first sentence, ending with the words "Portland, Oregon", of paragraph 5(d) of the petition. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in said subparagraph.

(e) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(e) of the petition.

(f) Admits that the First National Bank of Portland proposed a reorganization plan. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in paragraph 5(f) of the petition.

(g) Admits the allegations contained in paragraph 5(g) of the petition.

(h) Admits the allegations contained in the first sentence, ending with the words "Bank of Portland", of paragraph 5(h) of the petition. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth

or falsity thereof, denies the remaining allegations contained in said subparagraph.

(i) and (j) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(i) and (j) of the petition.

(k) Admits the allegations contained in paragraph 5(k) of the petition.

(l), (m) and (n) Denies the allegations contained in paragraph 5(l), (m) and (n) of the petition.

(o) Admits the allegations contained in paragraph 5(o) of the petition.

(p) Denies the allegations contained in paragraph 5(p) of the petition.

6. Denies generally and specifically each and every material allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioners' appeal be denied and that the Commissioner's determination of the deficiency be approved.

/s/ JOHN POTTS BARNES, JHP,
Chief Counsel,
Internal Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
John H. Pigg, Assistant Regional Counsel,
Internal Revenue Service.

Served and Entered June 22, 1956.

[Endorsed]: T.C.U.S. Filed June 20, 1956.

[Title of Tax Court and Cause.]

AMENDED ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, Herman T. Reiling, Acting Chief Counsel, Internal Revenue Service, and for amended answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that he erred in his determination of the deficiency in income tax as shown by the notice of deficiency from which the appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph 4(a) to (i), inclusive, of the petition.

5. (a) Admits the allegations contained in paragraph 5(a) of the petition.

(b) Admits the allegations contained in the first sentence, ending with the words "Portland, Oregon", of paragraph 5(b) of the petition. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in said subparagraph.

(c) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(c) of the petition.

(d) Admits the allegations contained in the first sentence, ending with the words "Portland, Oregon", of paragraph 5(d) of the petition. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in said subparagraph.

(e) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(e) of the petition.

(f) Admits that the First National Bank of Portland proposed a so-called reorganization plan. Denies the remaining allegations contained in paragraph 5(f) of the petition. Alleges that said plan did not provide for a reorganization within the meaning of section 112(g) of the 1939 Code.

(g) Admits that on January 20, 1953 the said so-called reorganization plan was approved by the stockholders of the First National Bank of Portland.

(h) Admits that on January 20, 1953, the said so-called reorganization plan was made effective by action of the Board of Directors of the First National Bank of Portland. Denies the remain-

ing allegations contained in paragraph 5(h) of the petition.

(i) and (j) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(i) and (j) of the petition.

(k) Admits that the respondent has determined that under the so-called reorganization plan the petitioners received on January 20, 1953 a dividend in kind measured by the fair market value of the First Securities Company stock on that date, and determined further that the value of said dividend was \$321.71.

(l), (m) and (n) Denies the allegations contained in paragraph 5(l), (m) and (n) of the petition.

(o) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph 5(o) of the petition.

(p) Denies the allegations contained in paragraph 5(p) of the petition.

6. Denies generally and specifically each and every material allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioners' ap-

peal be denied and that the Commissioner's determination of the deficiency be approved.

/s/ HERMAN T. REILING,
Acting Chief Counsel,
Internal Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
John D. Picco, Special Attorney, John H.
Pigg, Assistant Regional Counsel, Internal
Revenue Service.

Served: 2/19/57.

[Endorsed]: T.C.U.S. Filed February 19, 1957.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto through their respective counsel that in addition to the facts admitted by the pleadings, the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the rights of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. The petitioners Earl R. Wilkinson and Grayce E. Wilkinson are husband and wife residing at 4911 S. W. Broadmoor Drive, Portland, Oregon. During the taxable year 1953 the petitioner Earl R. Wilkinson was an employee and stockholder of the First National Bank of Portland and benefi-

ciary of a trust more fully described below. Petitioners filed a joint income tax return for the taxable year 1953 with the Director of Internal Revenue at Portland, Oregon.

2. The First National Bank of Portland was organized September 8, 1865. On January 20, 1953 it had 1,200,000 shares of its capital stock outstanding.

3. The First Securities Company was incorporated April 7, 1919. On January 20, 1953 it had 500 shares of capital stock outstanding. The capital stock of this Company has for over twenty years up to the time of the transaction in issue in this proceeding been owned by The First National Bank of Portland. Because of changes in the National Banking Act and the rules and requirements of the Comptroller of the Currency whereby national banks are restricted in regard to the extent and manner in which they may deal in investment securities, and the acquisition of stock in other corporations for their own accounts, it became necessary for The First National Bank of Portland to eliminate the stock of The First Securities Company from its assets.

4. Exhibit 1-A and its supporting Schedules A and B attached hereto are correct statements of the assets and liabilities of The First Securities Company on January 20, 1953 as shown by the books of the Company.

5. The fair market value of the net assets of The First Securities Company on January 20,

1953 was \$310,000.00. The respondent based his determination of the fair market value of The First Securities Company stock on the adjusted book value of the assets of the Company which he computed to be \$350,000.00. The correct adjusted book value of said assets on January 20, 1953, was \$310,000.00.

6. Exhibits 2-B and 3-C attached hereto are correct statements of the income and expenses and surplus of The First Securities Company for the calendar years 1951, 1952 and 1953, and balance sheets of said Company as of December 31, 1950, 1951, 1952, and 1953, respectively, as shown by the books of the Company.

7. Exhibits 4-D and 5-E attached hereto are Annual Reports to stockholders of The First National Bank of Portland as of December 31, 1952 and December 31, 1953, respectively, containing financial statements of said Bank for said years as shown by its books.

8. Exhibit 6-F attached hereto is a copy of the Form 1096 filed by The First National Bank of Portland in reporting to the Commissioner of Internal Revenue payments made by it in the year 1953.

9. The ruling published as Revenue Ruling 54-140 in CB 1954-1, page 116, is the ruling made by respondent as to the particular transaction involved in this case.

10. Exhibit 7-G attached hereto contains the daily bid and ask prices per share for The First

National Bank of Portland stock on the over-the-counter market during the period December 1, 1952, to April 1, 1953.

11. On January 20, 1953 a regular annual meeting of the shareholders of The First National Bank of Portland was held, at Portland, Oregon. A copy of the notice of said meeting, dated December 19, 1953, is attached hereto as Exhibit 8-H. With the said notice there was mailed to said shareholders a letter to said shareholders signed by F. N. Belgrano, Jr., President of said bank, and dated December 19, 1952, copy of which letter is attached hereto as Exhibit 9-I, which letter explains the purposes of and the reasons for the proposal to be submitted to the shareholders with respect to The First Securities Company stock.

12. At the said meeting, the shareholders took action as recorded in the excerpt from the minutes of said meeting attached hereto as Exhibit 10-J.

13. The Board of Directors of said bank held a meeting immediately following said shareholders' meeting and took action as recorded in the excerpt from the minutes of said meeting attached hereto as Exhibit 11-K.

14. Pursuant to the action taken by the shareholders and the Board of Directors, as aforesaid, the agreement of January 20, 1953 attached hereto as Exhibit 12-L was executed by the parties thereto, and on January 20, 1953, The First National Bank of Portland transferred the stock of The First

Securities Company to the trust created under said agreement.

15. No papers were distributed to the stockholders of The First National Bank of Portland evidencing their beneficial interest in the stock of The First Securities Company. The stockholders received nothing they could dispose of separately from the bank stock. No notation was made on the bank stock certificates evidencing beneficial interest in the stock of The First Securities Company.

16. The earnings and profits of The First National Bank of Portland during the taxable year 1953 exceeded \$350,000.00.

17. Exhibit 13-M attached hereto is a photostat copy of petitioners' joint income tax return for 1953.

18. Exhibits 14-N and 15-O attached hereto are photostat copies of the corporate income tax returns of The First Securities Company for 1952 and 1953.

19. The attached exhibits shall be considered as having been offered and received in evidence in this proceeding unless objection is made thereto and the objection is sustained.

/s/ GEORGE H. KOSTER,
Counsel for Petitioners.

/s/ HERMAN T. REILING,
Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

[Endorsed]: T.C.U.S. Filed February 19, 1957.

[Title of Tax Court and Cause.]

TRANSCRIPT OF PROCEEDINGS

U. S. Court of Appeals, U. S. Court House (New), Portland, Oregon. Tuesday, February 19, 1957.

The above-entitled matter came on for hearing, pursuant to Calendar Call, at 11:25 o'clock a.m.

Before: The Honorable Graydon G. Withey.

Appearances: George H. Koster, 300 Montgomery Street, San Francisco, California, on behalf of the Petitioner. John D. Picco, on behalf of the Respondent. [1]*

The Court: Now we will take 61977, the Wilkinson case. State your appearances, gentlemen.

Mr. Koster: George Koster, your Honor, appearing for the Petitioner.

Mr. Picco: John D. Picco, for the Respondent.

The Court: This is not a fraud case, I take it?

Mr. Picco: That is correct, it is not a fraud case. Before Petitioner goes on with his opening statement, we have found it necessary, right close to the end here, to amend our answer, to deny what inadvertently was admitted. There is no objection to that, since all the facts are stipulated anyway, and Respondent asks leave—in fact, they have a written motion for leave to file the amended answer at this time.

The Court: Is there an objection?

Mr. Koster: No objection.

* Page numbers appearing at top of page of Reporter's Transcript of Record.

The Court: It may be received.

Mr. Picco: And the motion is here—— (interrupted).

The Court: And the motion granted.

Mr. Picco: Copies have been turned over to Petitioner—— (interrupted).

The Court: All right. Do you have a stipulation of fact?

Mr. Picco: That is correct. I might put that in at the present time. The parties also ask leave to file the [2] complete stipulation of facts, your Honor.

The Court: And the last exhibit number?

Mr. Picco: 15-O—they are all joint exhibits.

The Court: I understand this is a joint motion to—— (interrupted).

Mr. Koster: Joint motion, your Honor.

The Court: The stipulation of facts, with the designated exhibits is received. I will now hear from Petitioner.

Mr. Koster: Your Honor, this case involves a proposed deficiency of one hundred and nine dollars and thirty-eight cents against Petitioner for the calendar year 1953. The deficiency results from the inclusion in Petitioner's taxable income by the Respondent of an amount of three hundred and twenty-one dollars and seventy-one cents, which he determined or asserts was the value of a dividend which this Petitioner received from the First National Bank of Portland, of which he was a stockholder. This case, your Honor, is representative of

a great many cases involving the tax liabilities of stockholders of this bank for the year 1953.

The facts will show that the First National Bank of Portland is a national banking association, has its principal office here in Portland, and does a banking business throughout the State of Oregon. For many years, it owned all of the five hundred outstanding shares of an Oregon corporation, known as The First Securities Company. The First Securities Company [3] acted as an auxiliary to the bank, and performed various functions which the bank itself could not do under the banking laws; for example, it would acquire and rent residences to employees of the bank in the localities where it was difficult to get adequate housing accommodations, and would take over various types of assets which the bank acquired through foreclosure of loans and which the bank could not retain long enough to liquidate them out because of the restrictions of the banking law, and functions of that sort.

Just prior to 1953, the United States Comptroller of the Currency, who has regulatory authority over national banks, concluded that the bank could not have these types of functions performed through a wholly owned subsidiary, and thereupon required that the bank dispose of its investment in The First Securities Company. The bank wanted to retain this medium for the uses that I have just described, and so devised a plan of reorganization, so-called, which would not only meet the requirements of the Comptroller of the Currency, but would also attain the bank's objectives to have this medium available.

Under this plan of reorganization, the bank proposed to declare as a dividend in kind, the investment in The First Securities Company, such distribution, however, to be made not to the stockholders of the bank—persons who held the one million two hundred thousand outstanding shares of stock of the bank, but to a trust which would be created for the purpose of [4] acquiring this stock for the benefit of the stockholders of the bank, as their interests might from time to time appear.

The shareholders of the bank, at a meeting on January 20th, 1953, approved that plan. As a result of that action, this Petitioner acquired a point four five nine five eight three and a third of a beneficial interest in the trust which acquired the stock of the bank—stock of the company. I might say that immediately after this action by the stockholders, the trust was created on January 20th, 1953, and the bank made a direct transfer of The First Securities' stock from itself to the trust. Now, in connection with that transaction, there were no certificates or no documents of any kind that were given to the shareholders—there was nothing which they received which they could dispose of separate and apart from the disposition of the stock of the bank which they owned. Now, as I say, as a result of this transaction, this Petitioner received this fractional beneficial interest in this trust, as an attribute of the eleven hundred and three shares of the First National Bank stock which he owned.

The Commissioner has determined that in effect, what this taxpayer received was a point four five nine five eight three and a third of a share of stock

of the First Securities Company, of a value of three hundred and twenty-one dollars and seventy-one cents, which the Commissioner then concludes and determines was a taxable dividend. Now, that value of three [5] twenty-one seventy-one was based on the adjusted book value of the assets of The First Securities Company, which the Commissioner computed at three hundred and fifty thousand dollars. In the stipulation of facts, it is now conceded that the correct adjusted book value and the fair market value of the assets of that company aggregated three hundred and ten thousand dollars. Now, the principal contentions of the Petitioner in this matter are these:

First, the commission to the Petitioner contends that this transaction was not a closed and completed transaction which had tax significance.

The Court: Which transaction?

Mr. Koster: The transaction of January 20th, 1953, involving the transfer of The First Securities Company stock to the trust and the receipt by the shareholders of a beneficial interest in that trust. We contend that that was not a closed and completed transaction of any tax significance, because there was no severance or change in substance in the Petitioner's unit investment in the stock of the bank and the stock of The First Securities Company. Secondly, we contend that the Petitioner received nothing of a fair market value as a result of this transaction. What the Petitioner received was a beneficial interest in this trust, but he received no document or tangible paper of any kind

which he could assign or transfer separate and apart from the bank stock which he owned. So, [6] with the beneficial interest of this type—— (interrupted).

The Court: May I stop you right there for just a minute. Is it your contention that regardless of the question of whether he received a tangible paper, is it your contention that he received no beneficial right or property right by that transaction, which he could dispose of?

Mr. Koster: That is correct, your Honor, which he could dispose of.

The Court: All right.

Mr. Koster: And that the restrictions with respect to the control and disposition of that were of such nature that it had no fair market value and whether this be treated as a dividend or not, he received nothing of value, and therefore realized no taxable income.

Now, we also have a third contention, and that is this, that this transaction was merely a change in form in the relationship between the bank and The First Securities Company, and that the Petitioner received nothing more than he had before. There was no change in the value of the Petitioner's stock holdings in the bank, nor was there any increase or increment in the value of his net worth as a result of this transaction, and we contend therefore that under those circumstances, there could be no realization of taxable income on such a transaction.

Now, we have a fourth contention, which is alternative, [7] and it brings into play quite some com-

plicated provision of the statute, and that's this, that should this transaction be recognized or construed as a dividend in kind of the stock of The First Securities Company, then the transaction would probably come within the provisions of the tax-free reorganization, distribution and exchange sections, a hundred and twelve B three and one hundred and twelve B eleven of the Revenue Code of 1939.

The facts as I have stated them, your Honor, are all set forth in the stipulation of facts, and that concludes my statement.

Mr. Picco: Now, counsel's statement of the facts is accurate, your Honor. I just want to add one or two other facts in that that may have some bearing, if you want to get the complete picture at the present time, and that is that the trust arrangement was authorized by the various beneficiaries of the trust, and that they had control over the trust—that is, the trustees, could not take any action without a majority of the beneficiaries acting. Moreover, by a majority vote, they could have this stock in the trust—the trust we raised—sold at any time they wanted to, so in that sense, whatever tie-up exists here was voluntary on the part of the beneficiaries themselves, and they at all times were in position and empowered to break up that tie-up, as I understand the facts.

Now, Respondent's position on the valuation issue [8] simply stated is this, that The First Securities Company is an investment company, it is not an operating company by any stretch of the imag-

ination. Respondent has determined that the stock of the company has value, is valuable, and that the fair market value is best measured by the underlying assets, which it has been stipulated have a fair market value of three hundred and ten thousand dollars.

On the principal issue, Respondent's position is that the transfer of the stock of this First Securities Company, on the particular date, January 20 of 1953, to the trustees, for the benefit of the stockholders of the bank, constituted a taxable distribution, that is, it constituted a dividend of the stock to the stockholders to the extent of the fair market value of the stock. Now, on this, there can be no question that the stock itself was severed from the assets of the bank. All rights that the bank had to the stock passed over at that time. Furthermore, immediately, the beneficial interest in the stock passed to the beneficiaries—to the stockholders of the bank. They now have an asset they never had before, and in addition to the beneficial interest, they also had effective control over the trust itself, as the trust issuance will show. The result of such a transaction, Respondent submits, is that it is a dividend of the stock to the bank stockholders.

Petitioner also, as he has mentioned, relies on the [9] spin-off provisions of Section a hundred and twelve B eleven, of the 1939 Code. It was apparent to Respondent that there is no reorganization in this case whatsoever. Furthermore, First Securities Company cannot really be called a party to any reorganization as required by the statutes. There may

be some question as to recapitalization, but again, it seems to me that it is going pretty far to call this a recapitalization, because it applies only—recapitalization applies only to the same entity and we have several entities here, including the trust.

The transaction, Respondent submits, does not meet the requirements of Section a hundred and twelve B eleven.

The Court: All right, that concludes the matter, gentlemen, I take it? I will set the usual sixty days for simultaneous briefs and thirty days for reply.

The Clerk: Those dates, gentlemen, are April 22nd and May 22nd.

(Whereupon, at 11:40 o'clock a.m., the hearing in the above-entitled matter was concluded.) [10]

[Endorsed]: T.C.U.S. Filed April 8, 1957.

29 T. C. No. 45

Tax Court of the United States

Earl R. Wilkinson and Grayce Wilkinson, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Docket No. 61977. Filed December 6, 1957.

OPINION

A national bank, in which petitioner was a stockholder, owned all the shares of a subsidiary which performed functions related to the bank's activities. An order of the Comptroller of the Currency made

it necessary for the bank to divest itself of this stock. A plan was devised whereby the bank transferred the stock to trustees, who were to hold legal title to such stock with a beneficial interest in the stockholders of the bank. The stockholders received nothing to evidence their beneficial interest in this trustee stock. The beneficial interest was locked in with the bank stock, and it could not be disposed of separately from the bank stock.

Held, the transfer by the bank of its subsidiary's stock to the trustees did not constitute a taxable dividend to the petitioner.

George H. Koster, Esq., for the petitioners.

John D. Picco, Esq., for the respondent.

Opinion

Mulroney, Judge: Respondent determined a deficiency in the petitioners' income tax for the year 1953 in the amount of \$109.38.

The sole question in the case is whether petitioner, a stockholder in a banking corporation, received a taxable dividend by virtue of a transaction wherein the bank transferred stock which it owned in a securities company, to trustees, for the benefit of all the bank stockholders.

All of the facts have been stipulated and they are hereby found accordingly. Petitioners Earl R. Wilkinson and Grayce Wilkinson, husband and wife, are residents of Portland, Oregon. They filed a joint income tax return for the taxable year 1953 with the district director of internal revenue at

Portland, Oregon. Earl R. Wilkinson will hereinafter be referred to as the petitioner.

In 1953 petitioner was a stockholder in the First National Bank of Portland, hereinafter called the Bank, holding 1,103 shares of the capital stock of said Bank. The Bank was organized in 1865 under the National Banking laws. On January 20, 1953, it had outstanding 1,200,000 shares of common stock with a par value of \$12.50 per share.

The First Securities Company, hereinafter called Securities, was incorporated on April 7, 1919 under the laws of Oregon. In 1931 the Bank acquired all of the capital stock of Securities and the latter remained a wholly-owned subsidiary of the Bank until January 20, 1953. On that date Securities had 500 shares of stock outstanding. Securities performed functions which the Bank itself was not able to perform under the National Banking laws, such as the liquidation of assets acquired by First National through foreclosures on loans, the purchase of residence properties for rental to employees of the Bank, and the acquisition of other property which the Bank itself could not acquire but which would inure to its interest. Its assets on January 20, 1953 consisted of cash, contracts and loans receivable, stocks and bonds, assigned life insurance policies, and real estate. The fair market value and the adjusted book value of the net assets of Securities on January 20, 1953 was \$310,000. The income of Securities in 1953 consisted of rentals, interest, dividends, and gain from the sale of properties. The

earnings and profits of Securities for the year 1953 exceeded \$350,000.

At the regular annual meeting of the shareholders of the Bank held on January 20, 1953, the shareholders took action with regard to Securities stock, as recorded in the minutes of said meeting, wherein they approved a plan to have the Bank transfer all of the shares of Securities to the five directors of the Bank acting as trustees, under a trust instrument, for the pro rata benefit of the stockholders of the Bank. Immediately after the stockholders' meeting the directors of the Bank held a directors' meeting and took action as recorded in the minutes of said meeting, directing the transfer of the 500 shares in Securities to the named Bank directors as trustees under the trust instrument prescribed by the resolution of the stockholders' meeting. On the same date the trust instrument was executed between the Bank and the trustees and the stock in Securities was transferred thereunder to the trustees. The trust instrument provided, in part, as follows:

1. Said shares of stock shall be held by the Trustees as joint tenants and not as tenants in common. The Trustees may and shall exercise all the rights, powers and privileges of absolute owners of said stock, including, but not limited to, the right to vote the same for any purpose whatsoever, to receive and receipt for any and all dividends, liquidating or otherwise, to sell, assign or transfer said stock or any portion thereof or any interest therein or any proceeds or other assets of any kind

derived therefrom, provided that any action so taken, whether in the election of Directors, the sale or other disposition of the assets of this trust or otherwise, shall have been first authorized by beneficiaries owning at least a majority of the beneficial interests in the assets of this trust, or such other percentage as may be hereinafter prescribed, evidenced in the manner stated in this agreement.

2. (a) The beneficial interest in said shares of stock of The First Securities Company shall be and is vested ratably in all of the shareholders of the Bank (hereinafter sometimes referred to as the beneficiaries) in the same proportion as they shall from time to time own of record stock of said Bank.

(b) Such beneficial interests may be sold, transferred or assigned only by the ratable transfer upon the books of the Bank to the same transferees of the same proportionate number of shares of stock of the Bank itself, but such beneficial interests shall not be and are not capable of separate transfer or assignment, either voluntarily or involuntarily, or in any other manner or by any other means than that herein specifically prescribed.

(c) At any and all times when, as stockholders of the Company, the Trustees shall receive dividends either from the profits of the Company or from liquidating dividends, partial or final, or from the sale or other disposition of the stock of the Company, the Trustees shall distribute such dividends or cause the same to be distributed to the beneficiaries ratably in accordance with their respective interests in the assets of this trust, determined

in the manner prescribed by this agreement. If and when any dividends are declared by the Directors of the Company the Trustees may, instead of receiving and distributing them as herein provided, authorize and empower the Company to make such distribution direct to the beneficiaries in accordance with their respective interests therein, in which event the Trustees shall be relieved of further responsibility therefor.

* * * * *

6. Meetings of the beneficiaries may be called and held in the manner following:

* * * * *

(b) Meetings of the beneficiaries may be called by the Trustees at any time upon giving the notice hereinafter prescribed. Upon the written request of the then owners of record of at least ten per cent (10%) of the beneficial interests then outstanding, the Trustees shall call a meeting to be held at such time and place as they may deem appropriate, but at all events not more than thirty (30) days after receipt of such request. In the event of the failure, neglect or refusal of the Trustees so to do, the then owners of not less than ten per cent (10%) of the beneficial interests then outstanding shall be entitled to call the meeting by giving notice as hereinafter provided.

* * * * *

(d) Voting at such meetings may be in person or by proxy. Any number of persons beneficially interested hereunder, together owning a majority of the beneficial interests in the stock held in this

trust, who shall be present in person or represented by proxy at such meeting shall constitute a quorum for the transaction of business. The affirmative vote of the persons present, in person or represented by proxy, owning at least a majority of the beneficial interests in the stock held hereunder shall be necessary for the transaction of all business and for the adoption of all resolutions, except where a different percentage vote is prescribed hereunder.

* * * * *

7. (a) This trust or the terms and conditions of this agreement may be amended, modified or terminated at any time by the affirmative vote of the then owners of not less than ninety per cent (90%) of the outstanding beneficial interests in the assets of this trust. Such vote shall be at a meeting of the beneficiaries called and held in the manner hereinbefore provided. Such amendment, modification or termination shall become and be effective thirty (30) days after the date of the meeting of beneficiaries at which the favorable affirmative vote was taken.

* * * * *

(c) In the event of termination of said trust the assets contained therein shall be promptly distributed by the Trustees to the then beneficiaries of the trust, comprising all of the stockholders of the Bank on the effective date of termination of the trust, on a pro rata basis in proportion to their ownership of beneficial interests in the trust.

No papers were distributed to the stockholders of the Bank evidencing their beneficial interest in

the stock of Securities. The stockholders received nothing they could dispose of separately from the stock of the Bank. No notation was made on the Bank stock certificates evidencing a beneficial interest in the stock of Securities.

Respondent determined the foregoing transaction constituted the distribution to the petitioner and the other Bank stockholders, of a dividend in kind, consisting of all of the stock in Securities within the meaning of section 115 (a) of the Internal Revenue Code of 1939,¹ on the basis of a fair market value of Securities' stock on January 20, 1953 of \$310,000, which determination accounts for the deficiency involved.

Petitioner did not include any amount in his income for 1953 on account of this transfer by the Bank of Securities stock to the trustees. Petitioner's argument is that the transfer did not result in any income to him because such transfer "effected merely a change in form in one of petitioner's investments but did not separate or liquidate that investment, nor did it afford any possibility for the realization of any monetary or proprietary gain of any kind", and that, in any event, even if such transfer were deemed to be a distribution of property to the petitioner, there would be no tax consequences because the property so distributed had no fair market value. In the alternative, petitioner argues that the effect of the trans-

¹ All section references are to the Internal Revenue Code of 1939, as amended, unless otherwise noted.

action of January 20, 1953 was either (1) a non-taxable spin-off within the meaning of section 112 (b) (11), or (2) a nontaxable exchange under section 112 (b) (3).

It is the substance of a transaction that determines whether a corporate distribution constitutes a dividend. And the liability of a stockholder for income tax on a corporate distribution depends basically upon whether that distribution constitutes income to him. *Coudon v. Tait*, 56 F. 2d 208. In *United States v. Phellis*, 257 U.S. 156, it was pointed out: "The liability of a stockholder to pay an individual income tax must be tested by the effect of the transaction upon the individual." Income is something that comes to a taxpayer so the basic question is whether the receipt by petitioner of the beneficial interest in Securities stock increased his income for that year. We hold it did not and the transaction did not amount to a dividend distribution taxable to petitioner.

The device here involved seems to be a plan often put forward by banking corporations to allow a bank's shareholders to take advantage of what the bank feels is proper banking business, which the bank as an entity cannot avail itself of. It accomplishes all of the advantages of a subsidiary for the bank without the usual shareholding of a subsidiary. But the adoption of the plan of trusteeing the stock of the corporation and locking the beneficial interest in the stock to the bank shares, results in no realization of income to the bank shareholders when the stock in the corporation

was formerly owned by the bank. The share of bank stock represents to the bank shareholder substantially the same beneficial ownership in the same assets both before and after the transaction.

The plan in the instant case was adopted to meet the requirements of the Comptroller of the Currency. It was a plan whereby the Bank would rid itself of Securities, its wholly owned subsidiary, and still retain for its stockholders the benefits that had resulted from its being a Bank subsidiary. Evidently such a transfer satisfied the requirements of the Comptroller but a realistic look at the transaction shows that to all intents and purposes Securities was retained by the Bank as an available medium to perform the same auxiliary business functions as were performed by it before the transfer.

From the Bank stockholders' position, it is difficult to see how any change resulted from the transfer that gave rise to the realization of gain. Petitioner's investment was, in substance, exactly the same after the transaction as before. Before the transaction petitioner's investment and the investment of all the Bank shareholders, might be said to be direct ownership of the stock of the Bank and solely by reason of such ownership, indirect ownership of the stock of Securities. After the transfer petitioner and the other Bank shareholders had the same investment, namely, direct ownership of the Bank stock and solely by reason of such ownership, indirect or beneficial ownership of the stock of Securities. While in form there was a severance of

Securities stock from the Bank assets, the petitioner and the other stockholders in the Bank received nothing they did not have before, as a result of the transaction. The beneficial ownership of the stock of Securities, after the transaction, was still locked into ownership of the Bank stock. It was still a pro rata interest depending upon ownership of the Bank stock. That beneficial interest could not be transferred without transfer of the Bank stock. If, the day after the transfer, petitioner had sold his Bank stock, he would have transferred substantially the same investment as to Securities stock as if the transfer had been made the day before.

Respondent cites a line of cases where a bank has declared a cash dividend, or a dividend consisting of surplus assets, which by agreement of the bank's shareholders was paid over to trustees for the purpose of organizing a corporation to transact business in which the bank could not engage. There, too, the stock in the new corporation was to be held in trust for the bank's shareholders, and its disposition was tied to existing stock ownership in the bank. Respondent cites *John G. Lonsdale*, 11 B.T.A. 659, affirmed 32 F. 2d 537, certiorari denied 280 U.S. 575; *Mrs. Frank Andrews*, 26 B.T.A. 642; *Walter Hopkins*, 27 B.T.A. 1331; and *Sara A. Twohy*, 34 B.T.A. 444.

The foregoing cases are not in point. There the income is realized by the payment of the cash dividend to or for the bank shareholder. The fact that, by prior agreement the shareholder's cash dividend was diverted to the purchase of stock, was imma-

terial. As said in *Lonsdale v. Commissioner*, 32 F. 2d 537 (affirming *John G. Lonsdale*, 11 B.T.A. 659):

Appellant [bank shareholder] received a distinct individual gain by the declaring of the dividend in question. The fact that he did not receive the cash in hand, but permitted the cash dividend thus declared to be used in the purchase of stock in another distinct corporation, did not alter the substantial effect of the transaction; * * *

In the above cited cases the bank shareholder received something new that was purchased with his cash dividend. Here what the Bank shareholder received was substantially the same beneficial interest in Securities stock that he had before the distribution.

Petitioner cites *Moore v. Hoey*, 31 F. Supp. 478; *DeCoppet v. Helvering*, 108 F. 2d 787, affirming *Andre DeCoppet*, 38 B.T.A. 1381; and *Commissioner v. Hagerman*, 102 F. 2d 281, affirming 34 B.T.A. 1158. These are cases where substantially the same plan as here was employed by banks to secure an arrangement for an investment affiliate. There the bank stock carried with it the ratable beneficial interest in trustee stock for an investment company dealing in securities that were unlawful for banks. There, as here, the bank directors were the trustees and the stock in the investment company was in the name of the trustees, with the beneficial interest in the bank shareholders. This

beneficial interest could not be transferred separately and it was automatically transferred with the transfer of the bank stock. In these cases it was held no deductible loss was realized by a bank shareholder where his beneficial interest in the investment company was extinguished with its dissolution with no assets to distribute in liquidation. While the question was quite different in the above cited cases, the principle on which the decisions rest is of interest here. The general principle laid down in the cited cases is that bank stock and the beneficial interest in the investment company represented a "single" investment and if there were any differences between the trustee plan and the usual shareholding of a subsidiary they were merely formal. As Judge Learned Hand said in *DeCoppet v. Helvering*, *supra*: "For all purposes except conformity with banking requirements the result was, however, substantially the same as though the Bank itself held the shares." The formal legal differences that exist between the usual shareholding of a subsidiary and the trustee shareholding here involved are unimportant when the inquiry is whether the transfer shall be deemed a taxable transaction for the shareholder. Where the transfer to the trustee is made under an agreement which limits the rights and privileges of the shareholders of the bank to substantially the same rights as to the stock of the bank's subsidiary as existed before the transfer, no taxable dividend to them occurs by reason of the transfer.

Respondent makes much of the point that the

trust agreement provides no action can be taken by the trustees without the consent of a majority of the holders of the beneficial interests. This, respondent argues, shows that the stock was in effect transferred from the Bank to the Bank's stockholders who thereby became free to control the stock. This same argument was rejected in *DeCoppet v. Helvering*, *supra*, where the Court said:

The beneficial interest was as much an appurtenance of the bank shares as an easement is of the servient tenements; it merely gave them an added value, precisely as it would have done, had the Bank been the shareholder. Collectively the same persons must always be equitable owners of the investment shares and shareholders of the Bank, and in the same proportion; there never could be one group holding bank shares, and another holding investment shares. So far as a corporation is the aggregate of its shareholders in respect of their collective rights and obligations, there was but one corporation.

We do not see why the situation was different because the bank shareholders could modify the trust by a two-thirds vote, if the trustees agreed; and could terminate it by a three-fourths vote, if they did not. * * *

The authority of the Bank shareholders as beneficiaries was no greater than the authority which they possessed with reference to the Securities stock when it was held as an asset of the Bank. The

Bank shareholders by collective action of a majority could have controlled the Securities stock when it was an asset of the Bank, though the exercise of that power might be limited to the election of a new board.

The Bank and its stockholders had the right, for good business reasons, to impose restrictions on the transfer which would render it no more than formal; which would leave the Bank stockholders substantially the same rights in the transferred stock as they held before. As long as that kind of a transfer satisfied the Comptroller, the whole purpose of the transfer was accomplished. But such a transfer involves no change in substance as to the rights of the petitioner as a Bank shareholder in the Bank asset transferred, which could be an occasion for determining a taxable gain. We hold the transfer of Securities stock of January 20, under the Trust Agreement did not result in a distribution by the Bank of a dividend in kind.

Our holding for petitioner eliminates the necessity for our considering the issue as to the market value of Securities stock on the date of the transfer, and the alternate arguments made by petitioner that if he did receive a dividend distribution, it was a nontaxable distribution within the provisions of section 112 (b) (11) or a nontaxable exchange of securities under section 112 (b) (3).

Decision will be entered for the petitioners.

Served and Entered December 6, 1957.

petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by the Tax Court of the United States on December 6, 1957, ordering and deciding that there is no deficiency in taxpayers' income tax for the calendar year 1953.

Taxpayers filed a joint income tax return for the year 1953 with the Director of Internal Revenue at Portland, Oregon, whose office is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

Nature of Controversy

In 1953, taxpayer, Earl R. Wilkinson, was a shareholder in the First National Bank of Portland. The Bank owned all of the stock of The First Securities Company, a corporation organized under the laws of Oregon. The First Securities Company performed functions which the Bank itself was unable to perform under the National Banking laws. On January 20, 1953, the shareholders approved a plan pursuant to which the Bank transferred all of the shares of The First Securities Company to trustees under a trust instrument for the benefit of the shareholders of the Bank.

The Commissioner of Internal Revenue determined that by reason of the foregoing transaction the shareholders of the Bank received a taxable dividend in kind equal to the fair market value of the stock transferred to the trust. The Commissioner determined that the fair market value of the corporation's stock was \$310,000 on January 20,

1953, and that it had earnings and profits in excess of that amount. A deficiency was asserted against the taxpayer based on his pro rata share of the distribution.

The Tax Court held that taxpayer, as a shareholder of the Bank, did not receive a dividend, within the meaning of section 115(a) of the Internal Revenue Code of 1939 by reason of the aforesaid transaction.

/s/ CHARLES K. RICE, CAR,
Assistant Attorney General,

/s/ ARCH M. CANTRALL, CAR,
Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Of Counsel: Charles P. Dugan, Special Attorney,
Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed March 3, 1958.

[Title of Court of Appeals and Tax Docket No.
61977.]

NOTICE OF FILING PETITION
FOR REVIEW

To: George H. Koster, Esquire, 300 Montgomery
Street, San Francisco 4, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of March, 1958, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for

the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 3rd day of March, 1958.

/s/ ARCH M. CANTRALL, CAR,
Chief Counsel, Internal Revenue Service, Counsel
for Petitioner on Review.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. Filed May 13, 1958.

[Note: Item 12 is the same as Item 11 except it is addressed to Mr. Earl R. Wilkinson and Mrs. Grayce Wilkinson, 4535 S. W. 78th Avenue, Portland, Oregon.]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 14, inclusive, constitute and are all of the original papers on file in my office as called for by the "Designation of Contents of Record on Review", including Joint exhibits 1-A thru 15-O, attached to the Stipulation of Facts, in the case before the Tax Court of the United States docketed at the above number and in which the

Respondent in the Tax Court has filed a Petition for Review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 16th day of May, 1958.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Endorsed]: No. 16031. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Earl R. Wilkinson and Grayce Wilkinson, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: May 26, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In The United States Court of Appeals
For The Ninth Circuit

No. 16031

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

EARL R. WILKINSON and GRAYCE WILKIN-
SON, Respondents.

STATEMENT OF POINTS TO
BE RELIED UPON

The Commissioner of Internal Revenue submits the following statement of points upon which he intends to rely as the basis of the petition for review:

That the Tax Court of the United States erred:

1. In failing to hold and decide that the transaction in question constituted a distribution to the taxpayer, as a stockholder of the First National Bank of Portland, of a dividend in kind within the meaning of Section 115(a) of the Internal Revenue Code of 1939.

2. In failing to hold and decide that the property distributed to the taxpayer by the bank, as a dividend in kind, had a fair market value and therefore that the taxpayer realized gain taxable as ordinary dividend income to him.

3. In holding and deciding that as a result of the transaction in issue, the taxpayer as stockholder of the bank received no monetary or proprietary gain of any kind.

4. In holding and deciding that there is no deficiency in the taxpayers' income tax for the year 1953.

5. In failing to hold and decide that there is a deficiency in income tax for the year 1953 in the amount of \$109.38.

Dated: June 10, 1958.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for the Petitioner.

[Endorsed]: Filed June 12, 1958. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STIPULATION

It is hereby stipulated and agreed between the parties to the above-entitled proceeding, through their respective counsel, that, subject to the approval of the Court, in lieu of designating portions of the exhibits in this case for inclusion in the printed transcript, the parties will print as a part of their briefs the exhibits, or pertinent portions thereof, that they respectively rely on.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Petitioner.

/s/ GEORGE H. KOSTER,
Attorney for Respondents.

[Endorsed]: Filed June 14, 1958. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

DESIGNATION OF MATERIAL
PORTIONS OF THE RECORD

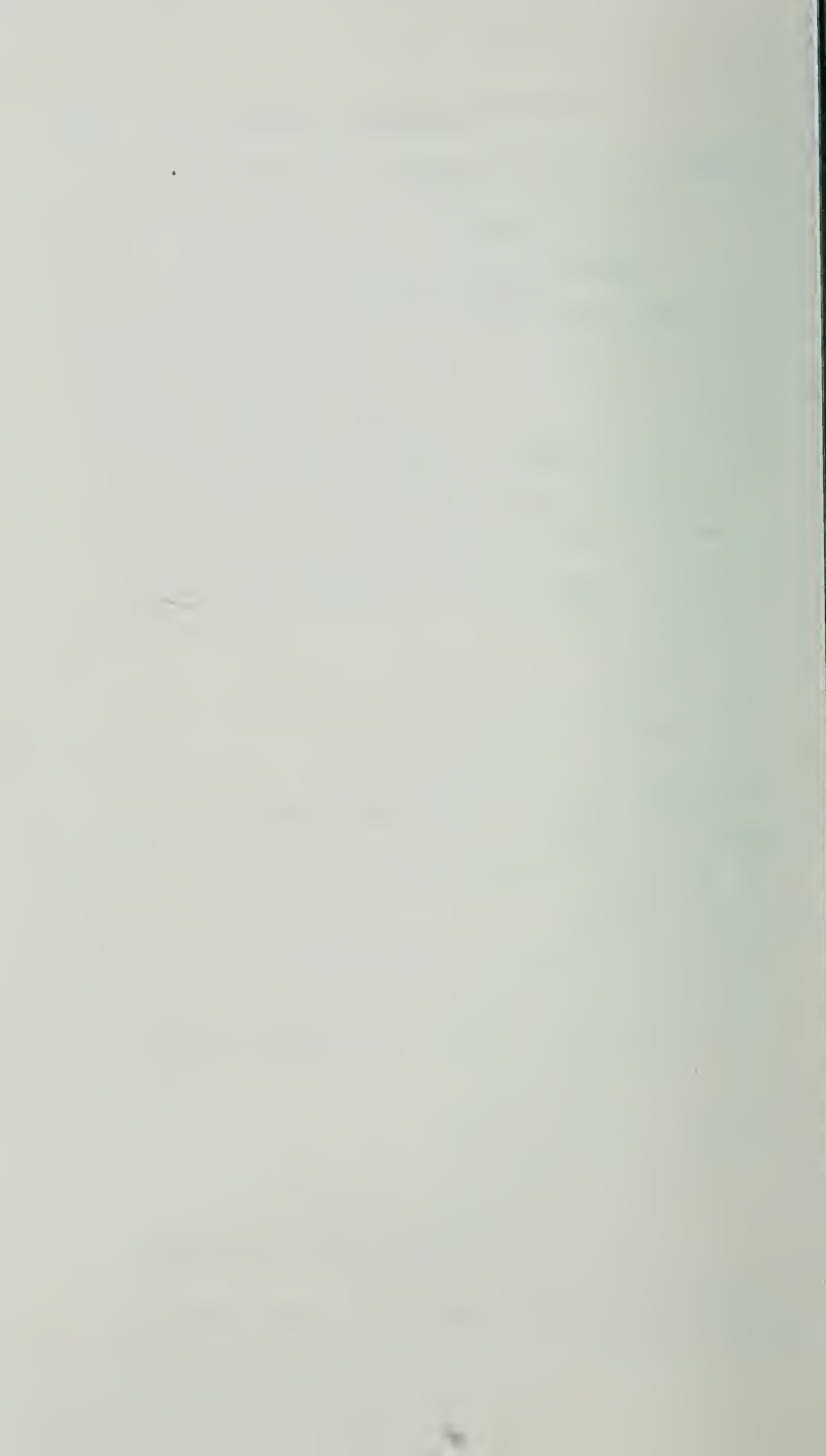
In accordance with Rule 17(6) of the Rules of the United States Court of Appeals for the Ninth Circuit, the Commissioner of Internal Revenue, petitioner herein, by his counsel, hereby designates the following portions of the record in the above-entitled case as material to the consideration of the petition for review, and requests that they be included in the record to be printed in this case:

1. Docket Entries.
2. Petition.
3. Answer.
4. Amended Answer.
5. Stipulation of Facts.
6. Transcript of Proceedings in the Tax Court, pages 2 through 10.
7. Findings of Fact, Opinion and Decision of the Tax Court.
8. Notice of Filing Petition for Review.
9. Petition for Review.
10. Statement of Points to be Relied Upon.
11. This Designation.

Dated: June 10, 1958.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for the Petitioner.

[Endorsed]: Filed June 12, 1958. Paul P. O'Brien, Clerk.



No. 16,033

**United States Court of Appeals
For the Ninth Circuit**

TRADEWIND TRANSPORTATION COMPANY,
LIMITED, (Formerly known as Allen
Tours of Hawaii, Ltd.),

Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

Appeal from the United States District Court
for the Territory of Hawaii.

BRIEF FOR APPELLANT

TRADEWIND TRANSPORTATION COMPANY, LIMITED.
(Formerly known as Allen Tours of Hawaii, Ltd.)

WILLIAM L. FLEMING,

*Attorney for Appellant, Tradewind Trans-
portation Company, Limited, (Formerly
known as Allen Tours of Hawaii, Ltd.)*

Of Counsel:

SMITH, WILD, BEEBE & CADES,
Bishop Trust Building, Honolulu, Hawaii.

FILED
Aug 1 1938
U.S. DISTRICT COURT
HONOLULU, HAWAII



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No. 16,033

United States Court of Appeals For the Ninth Circuit

TRADEWIND TRANSPORTATION COMPANY,
LIMITED, (Formerly known as Allen
Tours of Hawaii, Ltd.),

Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

Appeal from the United States District Court
for the Territory of Hawaii.

BRIEF FOR APPELLANT

TRADEWIND TRANSPORTATION COMPANY, LIMITED.
(Formerly known as Allen Tours of Hawaii, Ltd.)

JURISDICTION.

This action was commenced in the United States District Court for the District of Hawaii on December 18, 1956 (R. 65). The jurisdiction of the District Court was based upon §1332(a)(1) and §1322(b) of Title 28, U.S.C. As a result of the pretrial conference held on November 5, 1957, it was established that the appellee was a resident and citizen of the State of California, that the defendants were corporations

organized and existing under the laws of the Territory of Hawaii, and that the amount in controversy exceeded \$3,000.00, exclusive of interest and costs (R. 13).

Judgment on the verdict of a jury was entered in favor of appellee and against appellant in the District Court on November 8, 1957 (R. 69). Appellant, on November 18, 1957, filed its written motion to set aside the verdict and judgment entered thereon and its alternative motion for a new trial (R. 44). Appellant's motions were denied by the District Court on March 6, 1958 (R. 55, 56).

Notice of appeal was filed in the District Court by appellant on March 12, 1958. The jurisdiction of this Court is founded on 28 U.S.C., §1291 and §1294(1).

STATEMENT OF FACTS.

Introduction.

This was an action brought by the appellee against the Soto Mission of Hawaii, Ltd. (hereinafter referred to as the "Mission"), appellant, and others to recover damages for personal injuries sustained on June 13, 1956, as a result of a fall on the front steps of the Soto Mission Temple, located at 1708 Nuuanu Avenue, Honolulu, Hawaii (R. 3). The steps whereon appellee fell are depicted in plaintiff's Exhibits 1 and 2 (R. 353 and 354). The action brought by appellee was, as the result of facts brought out at the pretrial conference, dismissed as against the defendants Leong Hop Loui and Bernice Char Loui (R. 73).

(a) Facts Agreed Upon at the Pretrial Conference.

As a result of the pretrial conference the following facts were agreed upon by the parties as being undisputed (R. 13 through 15); the appellee was a citizen of the State of California, and the Mission and appellant were Hawaiian corporations. The Mission was a non-profit, eleemosynary corporation. The appellant, whose name was changed from Allen Tours of Hawaii, Ltd. to Tradewind Transportation Company, Limited shortly prior to the date of the trial in the District Court, was engaged, among other activities, in the business of transporting tourists to various points of interest on the Island of Oahu, Territory of Hawaii.

On June 11, 1956, the appellee, as a member of a tour party conducted by Transocean Airlines, purchased from the appellant for the sum of \$6.50 a ticket which entitled her to transportation on what is known as the Circle Island Tour. This consists of a trip around the Island of Oahu stopping at various points of interest on the way. At or about 8:30 a.m. on the morning of June 13, 1956, appellee, accompanied by three fellow members of the Transocean Airlines Tour party, entered an automobile owned by appellant and operated by one of its employees for the purpose of taking the aforementioned tour. At approximately 10:00 a.m. on the same morning, appellee was driven to the Soto Mission Temple at 1708 Nuuanu Avenue, Honolulu, Hawaii. The Temple and the premises upon which it is situated were owned by and were under the exclusive control of the Mission.

There was no contractual relationship between the appellant and the Mission. For several years members of the public have been allowed to enter the Temple and to observe the surroundings.

An accident occurred at the Temple on the morning of June 13, 1956, which resulted in personal injuries to the appellee. After the accident, appellee was taken to Queen's Hospital in Honolulu where she remained until she returned to California on June 27, 1956.

(b) Sequence of Events.

On the morning of June 13, 1956, after appellee and her three companions entered appellant's limousine, they were driven by Mr. Larry Pagay (who was as that time an employee of appellant) to the vicinity of the pier where the S.S. Lurline was to dock. They remained there for approximately half an hour and then proceeded back to the location where appellant's driver had told them to meet him (R. 84 and 117).

After the appellee and her companions had re-entered the appellant's limousine they proceeded to the Temple on Nuuanu Avenue, which Temple is also referred to in the record as the Buddhist Temple. The driver of the limousine drove up to the front steps of the Temple and allowed appellee and her companions to alight for the purpose of viewing the interior of the Temple (R. 118). Prior to the time, and at the time the appellee arrived at the Temple, it had been raining on and off and the steps and walks at the Temple were wet (R. 118). Appellee observed the condition of the steps at the time she

entered the Temple and knew that they were wet (R. 119).

On the date in question appellee was wearing a pair of open leathersoled sandals (R. 86) which she had purchased a short time previously and had worn approximately six times prior to the date in question (R. 120).

After appellee and her companions had inspected the interior of the Temple, the tour driver met them at the entrance to the door of the Temple (R. 119). At the time the tour driver met appellee and her companions he gave each of them a hibiscus (R. 175). He noticed "a little tickle about it" and the party subsequently started to move down the stairs (R. 175). After appellee had passed over a series of steps to the interim landing she testified that she started down the main portion of the steps and slipped and fell on the second or third stair (R. 90).

It has not been alleged, nor does the record reveal, that any foreign substance was on the steps at the time of appellee's fall. Appellee's testimony is to the contrary (R. 91) as is that of the witness Pagay (R. 176). The parties agree that the steps were wet when appellee fell and that the moisture was caused by rain.

After appellee's injury Mr. Pagay carried appellee to appellant's limousine and took her directly to the Emergency Department of Queen's Hospital in Honolulu (R. 93-94). As a result of her fall appellee suffered injuries to her person.

(c) Evidence Concerning the Condition of the Steps at the Soto Mission Temple.

The Mission was designed in 1950 by Mr. Robert T. Katsuyoshi, a licensed architect, and his partner Mr. Fuchino, who is a structural engineer (R. 268). The building was completed in 1952 at which time the Temple and unglazed quarry tile steps were inspected and approved by Mr. Katsuyoshi (R. 268). Mr. Robert B. Ebert, a Territorial Safety Inspector, who was called as a witness by appellee, also inspected the building while it was under construction (R. 146). The record fails to indicate his approval or disapproval of either the structure or the red unglazed quarry tile steps at that time.

Mr. Katsuyoshi inspected the stairs prior to trial and testified that except for weather and wear, the steps were substantially the same as they were when first constructed (R. 269). Appellee does not allege that the steps were worn at the time of her fall and appellee's witness Ebert testified that the weathering of tile stairs tends to make them less slippery (R. 140).

Mr. Marcus C. Lester was called as a witness on behalf of the Mission (R. 269). Mr. Lester testified that he was licensed in 1924 under the laws of the Territory of Hawaii as an architect and that he had been practicing architecture since that time (R. 269-270). Mr. Lester was familiar with quarry tile and stated that it was very ordinarily used for heavy duty floors for both interior and exterior work (R. 272). He affirmed that the steps of the Temple, both as to

design and material, conformed to the standards and practice recognized in the Territory of Hawaii (R. 272). Lester stated that quarry tile was customarily used without handrails or abrasive stripping, and that it was customarily used in exterior work (R. 273). He stated that it was one of the safest materials to use (R. 281) and that the steps in question were constructed in an excellent manner (R. 271). As an example of this type of construction of exterior stairways, the witness cited the City Hall of the City and County of Honolulu (R. 272), Roosevelt High School (R. 274) and the Hawaiian Electric Building (R. 275).

Mr. Robert B. Ebert identified himself as a safety engineer in the employ of the Department of Labor, Territory of Hawaii (R. 125). The witness Ebert had no college degree in either engineering or architecture, nor had he ever been licensed as such under the laws of the Territory of Hawaii (R. 125, 128).

The Court, over objection, allowed Ebert to testify as an expert with reference to the qualities of tile and its relationship to safety (R. 135). The witness testified that quarry tile contributed to falls (R. 135 and 141). In his experience this type of floor caused accidents (R. 143). Later the Court allowed the witness Ebert to testify over objection as "an expert on safety" (R. 156).

The witness Ebert testified that prior to June 13, 1956, the Mission should have (1) applied abrasive stripping to the steps in question (R. 148); (2) installed handrails (R. 155); or (3) used anti-slip tile

(R. 151). The witness did not know whether anti-slip tile was available in the Territory of Hawaii at the time the Temple was constructed (R. 152). Ebert admitted that his opinions were based upon a high degree of professional standards of safety (R. 160) and admitted further that safety was a question of degree and that the corrections he suggested were to obtain the "optimum" degree of safety (R. 161). This witness, on cross-examination, admitted that in his opinion a reasonably prudent person, as opposed to a safety engineer, would not be aware of any safety hazard that was present at the Soto Mission Temple in June of 1956 (R. 156, 157).

As stated earlier, the evidence is undisputed that the steps in question were wet when the appellee entered the Temple and when she left. Aside from this undisputed evidence, the only other witness to testify regarding the condition of the steps was Mr. Larry Pagay.

Mr. Pagay identified himself as an employee of Gray Line of Hawaii (R. 168). On January 29, 1956, he entered the employment of appellant and was assigned to work as a taxi driver on the night shift. He continued this work for approximately two and one-half to three months after which he became a tour driver (R. 169). Pagay testified that prior to his employment with appellant, he had taken various people to the Temple on "many occasions" (R. 181). He stated on cross-examination that, based upon his observation of the steps at the Temple, they were "less slippery than concrete steps" (R. 181) and

prior to the time of appellee's fall he had no experience of an unusual nature on the steps (R. 174).

On cross-examination by counsel for the Mission, this witness admitted that he had made a sworn statement prior to trial, one question of which read, "Have you ever had any knowledge of any member of your tour party or any other tour party falling on these steps?" Mr. Pagay's confirmed answer was, "not that I know of" (R. 186). During appellee's case in chief, Pagay testified that he had seen two or three people slip on the Temple steps prior to the date of appellee's fall (R. 171), but on cross-examination he qualified his prior testimony by stating that he had only seen one other person slip on the steps of the Temple. It was a driver whose identity was unknown to him (R. 177) since there were "hundreds" of drivers who go through the Temple (R. 170). This unidentified driver had not fallen (R. 185), and at the time of the incident Pagay was "very far from there" (the steps) (R. 171).

There is no evidence in the record to indicate whether at the time Pagay claimed to have seen the unidentified driver slip he was in the employ of appellant.

(d) The Contractual Relationship Between Appellant and Appellee.

The appellant on June 13, 1956, was engaged in the business of transporting passengers for hire to various points of interest on the Island of Oahu (R. 14). Normally, if a member of the public were to

purchase a ticket for the Circle Island Tour, he would be required to pay the sum of \$9.90. Appellant had a special contract with Transocean Airlines whereby appellant agreed to carry members of the airlines' tour on the Circle Island Tour for the sum of \$6.50 (R. 295). Under the terms of the contract between appellant and Transocean Airlines it was agreed that tour party members from Transocean Airlines would be furnished exclusive transportation, that is, members of the public would not be allowed to ride in vehicles which had been so assigned to the Transocean Airlines' customers (R. 295).

The appellee was a passenger of appellant under this special contract between appellant and Transocean Airlines. She purchased her ticket from the Transocean Airlines office for the sum of \$6.50 and the companions who accompanied her on the tour were all members of her tour party.

The customary procedure on a tour of this type was for appellant's driver to deliver the passenger to the location where the point of interest existed. The passenger (appellee in this case) was then free to make any inspection of the premises that she desired (R. 117, 118).

There is no evidence that the driver of the vehicle actually conducted the tour party about the premises wherein the inspection was to be made. Appellee was aware of this procedure for her party had prior to going to the Temple been let off at the Matson piers in Honolulu so they could go to observe the docking of the S.S. Lurline (R. 84 and 117).

Appellee's party, when they arrived at the Soto Mission Temple, had been let out in front of the Temple and they were not escorted about the grounds by the tour driver (R. 118). It was customary practice for the drivers, after depositing their passengers, to stay with their limousines and await the return of the passengers who were free to wander about and inspect the Temple (R. 171).

(e) The Proceedings in the Lower Court.

The trial of this action commenced on November 6, 1957 (R. 77). At the close of the appellee's case in chief, counsel for appellant and the Mission moved for a directed verdict (R. 247). The Court reserved a ruling on these motions. After all parties had rested and prior to the case being submitted to the jury, the appellant made a request of the Court for a directed verdict on its behalf (R. 18). This request was denied by the Court and the case was submitted to the jury who, on November 8, 1957, returned a verdict in favor of appellee and against appellant in the amount of \$14,545.00. At the same time the jury returned a separate verdict in favor of the Mission and against appellee. Separate judgments were entered on these verdicts (Docket entries, November 8, 1957) (R. 69).

Subsequently, and on November 18, 1957, appellant filed its motion for judgment and its alternative motion for new trial (R. 44). This motion was denied by the District Court on March 6, 1958.

QUESTIONS INVOLVED.

1. Did the District Court err in allowing Robert B. Ebert, appellee's witness, to testify over objection concerning his opinion as to whether the steps at the Temple were safe?

2. Was it error for the District Court to allow the witness Ebert to testify over objection that in his opinion the Mission should have installed certain safety devices on the Temple steps prior to June 13, 1956?

3. Was appellee's Exhibit No. 7 (a piece of abrasive stripping) properly admitted in evidence?

4. Did the District Court err in allowing the witness Ebert to qualify as an expert on safety and to state his opinions as to material and design of the Temple steps and the relation of the same to safety in view of the fact that by the witness' own testimony his opinions were based upon an optimum standard of safety and not upon a reasonable standard of care prevailing in the construction industry in the community?

5. Did the District Court abuse its discretion and commit prejudicial error in allowing counsel for appellee to attempt to impeach the architect, Mr. Lester, a witness for the Mission, by asking that witness whether he was aware of the fact that since the year 1947 the Safety Department of the Territorial Government had forbidden the use of quarry tile on exterior surfaces?

6. Did the District Court err in allowing counsel for the appellee to ask appellee's witness, Larry

Pagay, on redirect examination, his interpretation of what he meant in a prior sworn statement wherein he stated that he had never seen a member of a tour party slip on the Temple steps?

7. Did the District Court err in submitting to the jury the question of whether appellee's witness Pagay learned of the hazardous condition of the steps at the Temple prior to June 13, 1956?

8. Was there sufficient evidence upon which the jury could base a finding that the steps at the Soto Mission Temple on June 13, 1956, constituted a condition involving an unreasonable risk of harm?

9. Was there sufficient evidence to support a finding by the jury that appellant had notice of any hazardous condition which might have existed with respect to the steps of the Temple on June 13, 1956?

10. Was there sufficient evidence upon which the jury could base a finding that there had been a breach of any duty owing by appellant to appellee?

SPECIFICATIONS OF ERROR.

The District Court for the District of Hawaii is in error in this case in that:

1. The District Court erred in allowing appellee's witness Robert B. Ebert to state over objection his personal opinion concerning the safety of unglazed quarry tile stairs; such testimony was incompetent and constituted an invasion of the province of the jury.

“Q. Now, with reference to the tile that you observed last week at 1708 Nuuanu Avenue, what is your opinion from a safety standpoint as to that tile?

Mr. Fleming. I object, if Your Honor please. Again it is immaterial, incompetent and irrelevant. The question here is June 13, 1956, which is roughly a year and three months ago.

The Court. I will allow the witness to answer the question. I am certain that you will bring him back to such as that on cross-examination. And the jury will analyze the evidence accordingly.

A. In my opinion, and based on any number of observations with similar conditions, which have caused accidents, tile used in those stairs and the means used with no handrails, would contribute to an accident, could contribute to an accident.” (R. 140-141).

2. The District Court erred in allowing Robert B. Ebert, an expert witness on behalf of appellee, over objection to state his opinion with reference to the substance of tile and its relationship to safety.

“Q. (By Mr. Ingman.) What are the qualities of quarry tile, if you know?

A. The qualities of quarry tile are such, being a hard surface tile, from the safety standpoint will contribute to slips and falls because of the very nature of the tile, particularly when it is wet.

Mr. Knight. I object, Your Honor, and ask that the testimony be stricken. This man is not an engineer. He is not [221] an architect. And he is unqualified to give a conclusion, an opinion as stated.

The Court. I take it, Mr. Ingman, that this testimony you are asking of the witness relates to his qualifications in the field of safety engineering?

Mr. Ingman. That's correct.

The Court. Not as to ceramics or structural engineering?

Mr. Ingman. That's correct.

Mr. Knight. We submit, Your Honor, that the witness is not competent to state an opinion as to material, designed material.

The Court. Well, I don't ask the questions. The question is whether on the basis of his qualifications, and his experience, he can state an opinion with reference to the substance and its relationship to safety. And for that reason I will overrule the objection.

Mr. Fleming. May it please the Court, may my objection also be noted for the record?

The Court. Yes. Would you read the question?"

(R. 135.)

3. The District Court erred in allowing Robert B. Ebert, a witness for appellee, to testify over objection as an expert on safety.

"Q. (By Mr. Ingman.) Now, Mr. Ebert, with regard to this condition which existed at 1708 Nuuanu in June of 1956, are there any other methods of safeguarding the premises, were there any other methods of safeguarding the premises in your opinion?

A. Yes, there were.

Q. Would you state the method or methods?

A. The accepted method would be the installation of a hand rail.

Mr. Knight. Objection, Your Honor, and I ask that it be stricken. The man is not an architect or engineer and those questions—he is not qualified to answer in that regard. The question asked calls for opinion from such an expert.

The Court. I will permit him to testify as an expert on safety, not architectural or on construction——

Mr. Knight. Your Honor, we have not yet had a definition of safety. What is safety?

The Court. The objection is overruled.

Mr. Fleming. May I for the record have the same objection?

The Court. Yes. Does that conclude your direct examination? [244]

Mr. Ingman. I was just going to ask him what type of railing he suggested for these specific premises.

The Court. Very well.” (R. 155-156.)

4. The District Court erred when it allowed Mr. Robert B. Ebert, a witness for appellee, to give over objection his opinion concerning the overall design of the Temple steps and its relationship to safety.

“Q. Mr. Ebert, would you describe the exterior of the premises generally as they existed in June of 1956, beginning as you leave the outside door of the temple?

A. Well, as I remember, there is the same red quarry tile. Then there is an area with an abrasive-treated concrete section. Then it goes again to the stairway, made again of the red quarry tile.

Q. Is there anything objectionable in that from the safety standpoint?

A. Yes, there is.

Q. And would you state what that is, what the objectionable nature is?

A. The area that is treated with the abrasives constitutes a change in pace trip or fall hazard to a smoother surface.

Mr. Knight. Your Honor, I object. There is no evidence showing that this witness was aware or examined this section prior to June, 1956.

The Court. I thought his testimony was based on prior inspection. Is that correct?

The Witness. That's correct. [241]

Mr. Fleming. May it please the Court, I have an additional objection.

The Court. Yes.

Mr. Fleming. I believe the testimony has been from the plaintiff herself that she crossed this strip and that when she was on the second or third step she fell. So that based upon that, a general recitation of the various safety factors or lack thereof in the entire temple is not material to the issue of this case.

The Court. The objection overruled. It is time for our afternoon recess. Ladies and gentlemen of the jury, you will be excused for a ten-minute recess." (R. 152-153.)

5. The District Court erred in allowing Robert B. Ebert, appellee's witness, to testify from a safety standpoint about matters relating to quarry tile.

"Q. From a safety standpoint, what effect does the age of this type of tile have, what effect does the age of this type of tile have from a safety standpoint?

A. It depends on——

Mr. Knight. I object, Your Honor, to the question in that the witness has stated that he hasn't studied this kind of tile.

The Court. The objection is overruled.

Mr. Knight. To clarify it, that he is not competent to give the opinion asked on the basis of the record thus far.

Mr. Fleming. For the record I would like to——

The Court. Yes, as a matter of fact, I will consider that you are making the same objection, Mr. Fleming, to this line of evidence.

Mr. Ingman. Will you answer the question?

The Witness. I wonder if you would restate the question?

(The reporter read the question.)

A. It does one of two things, depending on the location of the tile, whether it is inside or outside, and the amount of wear and the amount of usage that it receives. It either becomes more slippery or becomes more abrasive, depending on where [227] it is, the conditions.

Q. Now, if the tile is outside unprotected from above, what effect does age have on the tile?

A. It could become less slippery, less slippery." (R. 139-140.)

6. The District Court erred in allowing Robert B. Ebert, a witness for the appellee, to testify over appellant's objection, that additional safeguards should have been installed on the Temple steps.

"Q. (By Mr. Ingman.) Now, Mr. Ebert, with regard to this condition which existed at 1708 Nuuanu in June of 1956, are there any other

methods of safeguarding the premises, were there any other methods of safeguarding the premises in your opinion?

A. Yes, there were.

Q. Would you state the method or methods?

A. The accepted method would be the installation of a hand rail.

Mr. Knight. Objection, Your Honor, and I ask that it be stricken. The man is not an architect or engineer and those questions—he is not qualified to answer in that regard. The question asked calls for opinion from such an expert.

The Court. I will permit him to testify as an expert on safety, not architectural or on construction——

Mr. Knight. Your Honor, we have not yet had a definition of safety. What is safety?

The Court. The objection is overruled.

Mr. Fleming. May I for the record have the same objection?

The Court. Yes. Does that conclude your direct examination? [244]

Mr. Ingman. I was just going to ask him what type of railing he suggested for these specific premises.

The Court. Very well.” (R. 155-156.)

7. The District Court erred in admitting into evidence over appellant’s objections a strip of adhesive abrasive as an additional safety factor which the Mission should have installed. (Plaintiff’s Exhibit No. 7.)

“Mr. Ingman. Yes, Your Honor, I offer that in evidence.

The Court. Any objection?

Mr. Knight. Your Honor, my objection is to the whole line of questions, that the witness is not qualified to give an opinion.

The Court. The objection will be overruled. It will be received as exhibit number 7.

(The strip of abrasive referred to was received in evidence as Plaintiff's exhibit number 7.)

Mr. Fleming. With the same understanding?

The Court. Yes, Mr. Fleming." (R. 150.)

8. The District Court erred in allowing counsel for the appellee on cross-examination, over the objection of appellant, to ask Mr. Marcus C. Lester, a witness on behalf of defendant Mission whether he knew that since 1947 the Territorial Safety Department has forbidden the use of tile quarry in the construction of exterior steps.

"Q. Are you aware of the fact that since the year 1947 the Safety Department of the Territorial government has forbid the use of that type of quarry on the outside?

Mr. Knight. I object, your Honor, assuming a fact not in issue.

Mr. Ingman. I offer to prove this, your Honor.

Mr. Knight.—assuming a fact not in issue. The fact is that Mr. Ebert said he was present when the building [383] was being constructed up there and visited it several times since.

The Court. Well, I will allow the question.

Mr. Fleming. Your Honor, may I enter the same objection, that it is assuming a state of facts not in evidence.

Mr. Ingman. I offer to show that by Mr. Ebert.

The Court. What is that?

Mr. Ingman. I offer to show by the testimony of Mr. Ebert that that has been the situation since the year 1947.

The Court. I don't recall that.

Mr. Ingman. I don't say that he has testified to that. I have just talked to him at recess, Your Honor.

The Court. Let's not talk in the presence of the jury about any conversation you had.

Mr. Ingman. I offer in connection with the objection to show——

The Court. I said I would allow the question.

Q. (By Mr. Ingman.) Will you answer the question, please?

A. I have never heard of any such restriction." (R. 277-278.)

9. The District Court erred in allowing counsel for appellee over appellant's objection to ask the appellee's witness, Larry Pagay, the following question:

"Q. (By Mr. Ingman.) When you said that no member of a tour party fell, did you mean to include the driver of the car?

Mr. Fleming. Objected to, if it please the court, as leading and suggestive.

The Court. The objection is overruled.

Q. (By Mr. Ingman.) Do you understand the question?

A. Yes, I do.

Q. Will you answer it, please?

Mr. Fleming. May I have a further ground to the objection that it is calling for the conclusion of the witness.

The Court. Objection overruled.

The Witness. Well, did you say this right [284] now, that—if the man mentioned only the tour driver or my tour party?

Q. (By Mr. Ingman.) By the words ‘tour party’ did you mean to include the driver?

A. No, not the driver, sir.” (R. 189-190.)

10. The District Court erred in refusing to give appellant’s requested instruction No. 1, which charged the jury to return a verdict for appellant (R. 18).

“The Court. As I say, I will make a final ruling. Number 1 will be refused.

Mr. Fleming. I object to the refusal to grant Number 1, the Trade Winds, for the reason that there is no evidence to support a verdict against the defendant, Trade Winds. There is no evidence sufficient for the jury to find that a dangerous condition did in fact exist. There is no evidence upon which the jury could find that the defendant had notice, actual notice or constructive notice of any dangerous condition which was hidden. There is no evidence of any breach of duty on the part of the defendant Trade Winds. And, further, a further objection that the undisputed evidence is that there is a conflict in testimony—that there is one whom we concede to [421] be an expert, the architect, and the other who was offered as an expert as to the condition of those premises on the date in question and there is a conflict of experts themselves. As a matter of law, the defendant, Trade Winds, could not be chargeable with notice of any dangerous condition. There is complete lack of proof of any breach of duty by this defendant to the plaintiff.” (R. 310.)

11. The District Court erred in its failure to submit appellant's instruction No. 12 as originally drafted (R. 24) save and except the amendment which substituted the phrase "unreasonable risk of harm" for the word "hazardous", and further erred over appellant's objection in submitting appellant's instruction No. 12 as modified to include the words "or its authorized employee" (R. 333).

"Mr. Fleming. Well, I will submit it as it is amended up to this point, your Honor.

The Court. Well, I will make the amendment myself by inserting after 'Limited', 'or its authorized employee'. [432]

Mr. Fleming. May I for the record object to any amendment to the instruction as originally given save and except the amendment relating to hazardous condition, and object to the amendment and failure to give the amendment with the above amendment 'or its authorized employee' for the reason that there is no evidence as to the authority of the one employee of whom you speak. I assume it being Mr. Pagay.

The Court. Very well. The exception is noted." (R. 320.)

Appellant's instruction No. 12, as given over objection by appellant, charged the jury to find for the appellee if the steps created an unreasonable risk of harm and if the appellant "or its authorized employee" had actual knowledge of the defect (R. 333).

12. The District Court erred in giving appellee's requested instruction No. 10 (R. 39) over appellant's objection.

Appellee's instruction number 10 charged the jury to find for appellee irrespective of what they might find as to defendant Mission if appellant's employee had learned of the condition in the scope of his employment prior to June 13, 1946 (R. 332). This instruction was given partially over appellant's objection.

“Mr. Fleming. I will object to Number 10 on the grounds that there isn't any evidence at all in the record to support the proposition in so far as it has to do with the tour company. There is an entire failure of proof on the part of the plaintiff to show such on the part of the tour company. There isn't any evidence to show that anyone learned of any dangerous condition during the course of their employment. The record is absolutely blank on that particular thing. And I might say there that Pagay admitted on cross examination that the steps were good, that they were less slippery than ordinary steps. That is verbatim.” (R. 305.)

13. The District Court erred when, after reserving its ruling on appellant's motions for a directed verdict at the close of appellee's case (R. 251), and at the close of the evidence (R. 296 through 300), and refusing to give (R. 310) appellant's requested instruction No. 1 requesting a directed verdict in favor of appellant (R. 18), it denied appellant's motion for a judgment notwithstanding the verdict to the contrary (R. 55).

Appellant's said motion for a judgment notwithstanding the verdict to the contrary was based on the

fact that there was not as a matter of law sufficient competent evidence to support or warrant a finding by the jury that the steps at the Soto Mission Temple on June 13, 1956, involved an unreasonable risk to the person of the appellee, that there was not sufficient competent evidence from which the jury could find that the appellant had notice of any such condition involving unreasonable risk to the person of the appellee, that there was not sufficient competent evidence to support the finding of the jury that there had been a breach of any duty owing by appellant to appellee and that the evidence adduced in the District Court with all inferences that could be reasonably and justifiably drawn from it, was not sufficient to provide a basis upon which a verdict could be rendered in favor of appellee against appellant (R. 44).

14. The District Court erred when after denying appellant's motion for a judgment notwithstanding the verdict to the contrary, it denied appellant's alternative motion for a new trial (R. 55), in that the verdict was contrary to law, and contrary to the evidence and the weight of the evidence, and that the appellant was entitled to a new trial pursuant to its motion (R. 46), by reason of errors committed by the District Court as more specifically set forth in appellant's specifications of error set forth in this brief.

SUMMARY OF ARGUMENT.**I.**

The District Court erred and abused its discretion by allowing Robert B. Ebert, a safety engineer, to testify as to his opinion on safety since this was an ultimate question of fact reserved for the jury and such testimony insofar as material invaded the province of the jury.

II.

In the absence of evidence of local custom and usage, it was prejudicial error for the District Court to admit over objections evidence as to safety devices which allegedly the defendant Mission should have incorporated into its Temple steps.

III.

The District Court committed prejudicial error in allowing improper examination by counsel for appellee of the witnesses Pagay and Lester.

IV.

There was no competent evidence upon which the jury could predicate a finding that the condition of the steps at the Soto Mission Temple on June 13, 1956, constituted an unreasonable risk of harm to the person of appellee.

V.

As a matter of law there was not sufficient evidence of the breach of any duty owing by appellant to appellee.

ARGUMENT.**I.**

IT WAS PREJUDICIAL ERROR FOR THE COURT TO ALLOW APPELLEE'S WITNESS ROBERT B. EBERT TO TESTIFY AS TO HIS OPINION CONCERNING SAFETY. SUCH TESTIMONY WAS INCOMPETENT AND ITS RECEPTION CONSTITUTED AN INVASION OF THE PROVINCE OF THE JURY.

This argument concerns appellant's specifications of errors Nos. 1 through 6, which deal generally with the opinion testimony of the safety engineer Ebert.

Appellant recognizes that a trial court has discretion as to who may qualify as an expert. Appellant concedes that it was within the discretion of the District Court to allow the witness to testify as to the qualities of unglazed quarry tile if on the basis of his previous testimony the Court felt him qualified to do so. Over objection the District Court allowed Mr. Ebert to testify not only as to the qualities of quarry tile but its relationship to safety (R. 135). Later the Court refused to allow the witness to give his opinion as to architectural or engineering matters but did allow him over objection to testify generally as an expert on safety (R. 156, Specifications of Error No. 6, this brief), even though there had been no definition of the term "safety" (R. 156).

Mr. Ebert's testimony is summarized in the statement of facts at page 7 of this brief. In addition to the testimony there set forth, Ebert was allowed to give his opinion that this type of tile caused accidents (R. 143), that a slip fall was due to this type of flooring (R. 144), and that any stairway built of quarry tile must have anti-slip treatment (R. 148).

One of the questions for the jury to decide in this case was whether the steps at the Temple were so constructed or maintained as to create a condition resulting in an unreasonable risk of harm, that is, were the steps negligently constructed or maintained? The testimony of Mr. Ebert as to what in his opinion should be done to safeguard the steps concerned the very question which the jury was called upon to decide. A parallel might be drawn in a case involving personal injuries arising out of an automobile accident where a police officer with wide experience in traffic matters would be called as a witness to give his opinion as to whether an individual driver involved in the accident acted with or without due care. Clearly, such testimony would be incompetent.

In *Nelson v. Brames*, 241 F.2d 256 (10 Cir. 1957), an expert who was a consulting engineer and professor was allowed by the trial court to testify that in his opinion the use of chains on automobile tires under the circumstances shown in the case was not advisable. In holding such testimony to be improper the appellate court stated:

“. . . It is the general rule that expert testimony is appropriate when the subject of inquiry is one which jurors of normal experience and qualifications as laymen would not be able to decide on a solid basis without the technical assistance of one having unusual knowledge of the subject by reason of skill, experience, or education in the particular field; that the admission or rejection of expert testimony rests largely in the sound judicial discretion of the trial court; and that when exercised within normal limits,

such discretion will not be disturbed on appeal. *Francis v. Southern Pacific Co.*, 10 Cir., 162 F.2d 813, affirmed, 333 U.S. 445, 68 S.Ct. 611, 92 L.Ed. 798; *E. L. Farmer & Co. v. Hooks*, 10 Cir., 239 F.2d 547. But the testimony that the use of chains was not advisable went beyond the range of that general rule. The effect of the testimony was to express the opinion that under all of the circumstances shown in the case an ordinarily careful and prudent operator of an automobile would have driven his car without chains. The effect of it was to express the opinion that under all of the circumstances shown, the operation of the automobile of defendants without chains did not constitute negligence. It was an expression of opinion upon a pivotal issue of fact for the jury. It amounted to a usurpation of the function of the jury. And its admission constituted error. *Gordon v. Robinson*, 3 Cir., 210 F.2d 192; *Pointer v. Klamath Falls Land & Transportation Co.*, 59 Or. 438, 117 P. 605; *Lehman v. Knott*, 100 Or. 59, 196 P. 476; *Lee Moor Contracting Co. v. Blanton*, 49 Ariz. 130, 65 P.2d 35; *Buehman v. Smelker*, 50 Ariz. 18, 68 P.2d 946; *Weng v. Schleiger*, 130 Colo. 90, 273 P.2d 356; *Wawryszyn v. Illinois Central Railroad Co.*, 10 Ill.App.2d 394, 135 N.E.2d 154; *Cone v. Davis*, 66 Ga.App. 229, 17 S.E.2d 849."

Lavoie v. Brockelman Bros., 315 Mass. 673, 53 N.E. 2d 999, 1000 (1944):

"There was no error in excluding the testimony of a witness whose business was the designing and equipping of stores, and who was offered as an expert, that the method of constructing the booth would create 'hazards to customers' and

that this type of cashier's booth is not safe 'from the customer's point of view.' The plaintiff had already been allowed to show all the characteristics of the booth and counter which she contended were defects. Whether these were hazardous to customers or unsafe from their point of view necessarily depended, in the circumstances of this case, upon where the customers had been invited to go. That was a question for the jury and not for the witness. Moreover, the conditions shown were such as to be easily comprehended by the jury, and it is difficult to see any necessity for the testimony of an expert. . . ." (Citations omitted.)

The following cases at the page noted support the aforementioned rule of law:

Morton's Adm'r. v. Kentucky-Tennessee Light & P. Co., 282 Ky. 174, 138 S.W.2d 345, 347-8 (1940);

Blinkinsop v. Weber, 85 Cal.App.2d 276, 193 P.2d 96, 99 (1948).

While appellant concedes that this Court is not bound by decisions of inferior Federal Courts, nevertheless, it is of interest to note the decision in the United States District Court for the District of Hawaii, made by the Honorable J. Frank McLaughlin on July 25, 1958, in the case of Paula C. Fraser and Robert A. Fraser, Plaintiffs, vs. Matson Navigation Company, a California Corporation, Defendant, the same being noted in the records and files of the Court as Civil No. 1535. A copy of the entire oral decision which was reduced to writing and the original tran-

script of which by the Rules of the Court was filed with the Clerk of the Court on August 1, 1958, is found in Appendix I of this brief.

This was an action brought by husband and wife against the the defendant for injuries suffered by the wife as a result of falling on the steps of the Royal Hawaiian Hotel in Honolulu. In setting aside the verdict in favor of the plaintiff and entering a judgment for the defendant, the District Court recognized its error in allowing Mr. Robert B. Ebert to testify as an expert with regard to the safety of the steps in question.

It is submitted that prejudicial error was committed by the lower Court in allowing Robert B. Ebert to testify as an expert on safety. The effect of condoning such a practice would be to open the doors wide to a flood of incompetent opinion evidence.

II.

IN THE ABSENCE OF EVIDENCE OF STANDARDS OF THE COMMUNITY, EVIDENCE IN THE FORM OF OPINION EVIDENCE AS TO WHAT ADDITIONAL PRECAUTIONS SHOULD HAVE BEEN PLACED ON THE STEPS IN THE TEMPLE WAS INADMISSIBLE.

This argument concerns appellant's specifications of error numbers 4, 6 and 7 supra.

The standard of care owed by the owner of a building to third parties is that of the responsible property owner under like circumstances. In *De-*

Weese v. J. C. Penney Co., 5 Utah 2d 116, 297 P.2d 898 (1956), the defendant store was held liable to one injured by a fall upon evidence that the store knew that terrazzo became slippery when wet and that it was defendant's custom and the custom of other stores to use rubber entrance mats in inclement weather, which in this case defendant had neglected to do. *Id.* p. 901. In so deciding the case, the court noted and distinguished the aforementioned and recognized standard of care.

"... Testimony as to the customs and practices of others similarly situated was admitted as bearing upon the issue of what ordinary and reasonable care under the circumstances was. Such was the only duty of care submitted to the jury as reflected in Instruction No. 10, wherein the court correctly charged that it was the defendant's duty, '* * * to exercise reasonable care to keep the entranceway to [its] store reasonably safe for the use of its customers.' "

"... ,

"The principal attack made upon the judgment relates to errors assigned in admitting certain testimony which defendant characterizes as 'an attempt by plaintiff to set up the purported actions and customs of W. T. Grant's store as a standard for defendant to meet.' There can be no doubt that it would not have been proper to use the procedure of any particular individual, or of the W. T. Grant Co. store, either generally, or in connection with this particular storm, as a standard of care upon which to determine whether the Penney Company was negligent. . . ." *Id.* 899.

The only evidence in the record as to the practice and customs prevailing in the community is that of the architect, Mr. Lester, who testified that the Mission steps both as to design and material conform to the standards of the Territory (R. 272).

Appellee's witness, Mr. Robert B. Ebert, testified over objections that the Mission should have applied an abrasive stripping (R. 148), or employed hand-rails (R. 155), and/or constructed the stairs with an anti-slip tile (R. 151) although he testified that he did not know when this type of tile became available in the Territory (R. 152).

Mr. Ebert did not purport to testify on the basis of standards of custom and usage prevailing in the community as established by other property owners; in fact, it later developed on cross-examination that the safety engineer admitted that the standards to which he testified were a high degree of professional standards for safety (R. 160), and that his testimony was predicated upon securing optimum safety (R. 161).

Where, as in this case a standard of safety is not properly defined (R. 156), the testimony of a safety expert is inadmissible.

“... An expert cannot be permitted to testify whether or not a certain practice is a ‘safe one,’ though he may, if properly qualified, testify whether or not the *common usage* of a business had been adhered to by the defendant. ‘The test of negligence is the ordinary usage of the business.’ *Ford v. Anderson*, 139 Pa. 261, 21 A. 18, unless, as stated above, a custom is so *obvi-*

ously dangerous as to be easily recognizable as such. An act cannot be branded as negligence because some expert or alleged expert characterizes it as an unsafe practice." (Italics added.)

Sweeney v. Blue Anchor Beverage Co., 325 Pa. 216, 189 Atl. 331, 335 (1937).

In *Blinkinsop v. Weber*, 85 Cal.App.2d 276, 193 P.2d 96 (1948), plaintiff, an employee manager of defendant's apartment building, sought recovery for personal injuries resulting from a fall on the steps of the apartment. In affirming a judgment for defendant, the court noted the standard of care upon which a breach of duty might be predicated.

"... The opinion of the witness as to whether the steps were built in accordance with standard and accepted construction and architectural practice should have been received. His opinion thereon might have been of some assistance in determining whether the defendants were negligent in maintaining the steps. . . ." (193 P.2d 96, 100).

In the same case the appellate court very carefully upheld the lower court's rejection of safety opinions about the steps in question.

"... It was not error to reject the opinion of the witness as to whether the steps were safe. 'Usually an expert cannot be asked whether a structure is a safe one, but all of the facts may be elicited from the witness from which the conclusion follows.' " (193 P.2d 96, 100).

In view of the fact that there was no evidence that the Mission did not adhere to the standards of due

care under the circumstances, evidence as to what safeguards the Mission should have installed for optimum safety had no bearing on the question of negligence.

III.

THE COURT ERRONEOUSLY ALLOWED OBJECTIONABLE AND PREJUDICIAL QUESTIONS TO BE ASKED BY COUNSEL FOR THE APPELLEE OF THE WITNESSES LESTER AND PAGAY.

- A. It Was Improper to Allow Counsel for the Appellee to Question the Architect Mr. Lester on Cross-Examination Based on an Assumption of Facts Totally Unsupported by the Record (Appellant's Specifications of Error No. 8).**

Over objection, counsel for the appellee was allowed on cross-examination to ask the witness the following question: "Are you aware of the fact that since 1947 the Safety Department of the Territorial Government has forbade the use of that type of quarry on the outside?" (R. 277).

At that point (and at the present), the record was devoid of any evidence that the Safety Department had made or had authority to make any such ruling.

Mr. Ebert, the safety engineer, had attempted to make many refernces to the laws of the Territory as regards safety (R. 142, 143, 149 and 152). The Court had admonished the witness Ebert that he was not to testify as to the law (R. 143). When this witness testified that abrasive stripping was required by law on quarry tile steps, such testimony was stricken by the Court (R. 149). The only applicable evidence of any rule or regulation of the Territory of Hawaii dealing with the subject matter is found in the testi-

mony of Mr. Ebert wherein he stated that the use of quarry tile was prohibited for use around machinery due to the oil making it slippery or dangerous (R. 152).

It is elementary that it is improper to ask a witness, whether on direct or cross-examination, a question which assumed a state of facts not in evidence. 3 *Jones on Evidence* (4th ed. 1938) §843, p. 1559 and cases cited in fn. 6. In this instance, after objection had been raised to the question, counsel for appellee advised the Court in the presence of the jury, that the basis of the question was a conversation that counsel had had with Mr. Ebert, the safety engineer, during a recess (R. 278). Thereafter, the witness Lester was allowed to answer the question and stated that he never heard of any such restriction (R. 278).

Subsequent to appellee's offer of proof a motion was made to strike the question and the answer (R. 292). At the commencement of trial the following day counsel for appellee stated that the question had been predicated upon rulings made under Act 64, Session Laws of Hawaii 1947 (Chapter 96, Revised Laws of Hawaii 1955). The Act in question, with the omission of the sections dealing with definitions and the sections dealing with injections and penalties, is set out verbatim in Appendix II of this brief. An examination of this law will clearly indicate that it was inapplicable as a basis for making the assumption of facts posing the question. The Court recognized this proposition and granted the motion to strike both the question and the answer (R. 292).

Admittedly, the question and answer were stricken on the following day of the trial, and the jury was instructed to disregard them. It is usually presumed that a jury will follow the Court's instructions. However, in this case the question asked of the witness was so clearly erroneous that the objection to it should have been sustained immediately. The effect of the failure of the Court to sustain the objection led directly to the events which followed, to-wit: A statement by counsel for appellee concerning the subject matter of an interview with the safety engineer during the recess (R. 278). The subject matter of this conversation between counsel and the safety engineer who had previously testified could not be erased from the minds of the jury by an instruction given on the following day to disregard the question and answer (R. 292).

B. The District Court Abused Its Discretion in Allowing the Witness Pagay to Testify on Redirect Examination as to His Interpretation of a Prior Sworn Statement (Appellant's Specifications of Error No. 9).

The witness Pagay was called as appellee's witness (R. 168). He was not a hostile witness towards appellee. On the contrary, the record indicates that he was friendly (R. 188). On direct examination, this witness acknowledged that he had made a prior sworn statement wherein he had stated that he had no knowledge of any member of his tour party or any other party falling on the steps (R. 186).

On redirect examination (R. 189, 190), the witness was asked whether when he made such statement he

meant to include a driver of the car. The question was objected to both from the grounds as to form, i.e. leading, and that it called for a conclusion of the witness. The objection was overruled and, as could be expected, the witness said that he did not intend to include the driver (R. 189, 190). Appellant recognizes that the propriety of interrogating a witness by means of leading questions is primarily one within the discretion of the trial Court and will not be subject to review unless an abuse of discretion is established. 3 *Jones on Evidence* (4th Ed. 1938) §819. Of course, it is difficult to determine what an abuse of discretion is in any given case as each depends upon its own peculiar facts.

Appellant submits that the situation which existed prior to the posing of this question to the witness presented the jury with the question of the credibility of a material witness. By allowing the question to be asked in this manner a conclusion was drawn which in effect usurped the province of the triers of fact. It is respectfully submitted that the lower Court under these circumstances exceeded the bounds of its discretion.

IV.

THERE WAS NO EVIDENCE THAT THE SOTO TEMPLE STEPS PRESENTED AN UNREASONABLE RISK OF HARM TO PLAINTIFF.

This argument concerns appellant's specifications of error numbers 10 and 13.

A. The Fact That Appellee Fell on the Temple Steps Creates No Presumption in Her Favor.

Unfortunately, as is so often the case, there are no Hawaiian "slip and fall" cases in point. Cases from other jurisdictions are so numerous that it would serve no useful purpose to attempt to digest them in this brief.

It has long been recognized that a mere slip or fall raises no presumption of negligence and is not evidence by which negligence may be assumed. An examination of these decisions, most of which involve invitees, reveals that the authorities have laid down certain general rules of law applicable to this type of case. It is established by the great weight of authority that the fact that a person falls on steps is not evidence of any negligence on the part of the person in control of the steps.

"The fact that invitee may have slipped on the floor of the store did not shift to defendant burden of establishing that accident did not occur through its negligence, nor create presumption of negligence. The presumption is that defendant exercised reasonable care, as respects liability for injury to plaintiff on account of slipping on floor. Defendant was not an insurer against accidents to persons entering the store for making purchases or otherwise on invitation.

"Unless plaintiff introduced sufficient evidence to make an issue that plaintiff slipped on the floor through negligence of defendant's employees, or because of condition of which defendant had actual or constructive notice, in time to remove the cause by mopping or by other means

which was its duty to reasonably do, recovery cannot be here affirmed.” *Sears, Roebuck & Co. v. Johnson*, 91 F. 2d 332, 338 (10 Cir. 1938).

In accord, *Wilkins v. Allied Stores of Missouri*, (Mo. 308 S.W. 2d 623, 629, (1958); *Copelan v. Stanley Co. of America*, 142 Pa. Super. 277, 17 A. 2d 659, 660 (1941). *Gaddis v. Ladies Literary Club*, 4 Utah 2d 121, 288 P. 2d 785, 786 (1955) and *De Baca v. Kahn*, 49 N.M. 225, 161 P. 2d 630, 635 (1945).

The reason for this rule is best summed up by the following holding in *Knopp v. Kemp & Hebert*, 193 Wash. 160, 74 P. 2d 924, 926 (1938):

“Walking, although it becomes automatic by long practice and use, is, after all, a highly complicated process. The body balance is maintained by the co-ordination of many muscles, and their operation is controlled by an intricate system of motor nerves, the failure of any of which for a split second, on account of advancing age or for some other reason, may cause a fall. It is common knowledge that people fall on the best of sidewalks and floors. A fall, therefore, does not, of itself, tend to prove that the surface over which one is walking is dangerously unfit for the purpose.”

(This case involved a slip fall on a wet terrazzo arcade.)

B. There Was No Competent Evidence of Either Improper Construction or Improper Maintenance With Regard to the Steps at the Temple.

In 1952 the Soto Mission Temple was designed and built under the direction of an architect and a struc-

tural engineer (R. 268). The building was inspected during construction by Mr. Robert B. Ebert, a safety engineer in the employ of the Territory of Hawaii (R. 146).

They were four witnesses who testified as to the condition of the Temple steps.

The appellee testified that she observed the condition of the steps when she entered the Temple and they were wet (R. 119). When identifying plaintiff's Exhibit 2 (a photograph of the Temple steps) appellee noted that the photograph contained something dark on the steps in question and testified that she did not remember this to be present on the steps at the time of her fall (R. 91).

Mr. Pagay, appellant's tour driver, testified that the stairs were less slippery than ordinary concrete steps (R. 181), and that there was no foreign substance other than rain on the steps (R. 176). When asked whether he had any experiences of an unusual nature on these steps prior to appellee's fall he stated that he did not (R. 174).

Mr. Lester, an architect, testified that the steps of the Soto Temple were constructed in an excellent manner (R. 271) and that the steps both as to material and design conformed to the established standards and practice of the Territory (R. 272). He further testified that wet unglazed quarry tile is no more slippery than cement on a sidewalk (R. 280) and that this type of tile is ordinarily used for heavy duty exterior work for both flooring and stairs (R. 273). Mr. Lester also stated that unglazed quarry tile is

customarily used without handrails or abrasive stripping (R. 273).

Mr. Ebert's testimony was to the effect that unglazed quarry tile should not be used in the absence of abrasive stripping (R. 148), or handrails (R. 155) unless the tile is of an anti-slip nature (R. 151). This witness did not know whether the latter was available in the Territory in 1952 when the Temple was constructed (R. 152).

Mr. Ebert was the only witness whose testimony might have given rise to an inference that there was anything wrong with the Temple steps. His testimony, even if it had been competent, was immaterial and formed no basis for a finding of negligence since, admittedly, the standards to which Mr. Ebert testified were those of a high or optimum professional standard of safety (R. 160-161) and not those of a reasonable man under the circumstances.

In order for appellee to prevail she must prove a distinct and tangible defect in the steps of the Temple and this she has failed to do. Note the holding in *J. C. Penney Co. v. Robison*, (28 Ohio St. 626, 193 N.E. 401, 404 (1934)) were a "slip-fall" verdict in favor of plaintiff was properly reversed.

"The case of *Gibbs v. Village of Girard*, 88 Ohio St. 34, 102 N.E. 299, largely relied upon by defendant in error, is not in point here, as there was in that case a specific definite defect, to wit, a two-inch offset in the sidewalk, shown by the testimony to exist. A distinct tangible defect was shown to exist in that case, while in the case

before us pure speculation must be indulged as to just what caused Mrs. Robison to slip.

“We agree that the right of trial by jury is guaranteed to all citizens by the Constitution of Ohio, and it cannot be invaded or violated by legislative act or judicial decree; but all this does not mean that all cases, regardless of evidentiary aspect, must be submitted to a jury. Under our law it is just as pernicious to submit a case to a jury and permit the jury to speculate with the rights of citizens when no question for the jury is involved, as it is to deny to a citizen his trial by jury when he has the right.”

See also *Gaddis v. Ladies Literary Club*, 4 Utah 2d 121, 288 P. 2d 785, 786 (1955) and *Sears-Roebuck & Co. v. Johnson*, 91 P. 2d 332, 338 (1937).

Appellant's position can best be summed up by an excerpt from Shearman and Redfield on Negligence, (Revised ed. 1941) §797, page 1820:

“It is not uncommon for a person to fall down stairs when there is no defect in the stairway or its covering. A heel may catch on the edge of the stair, or the carpet, and a fall results. The fault rests, not with the stairway, but with the person who so placed his foot. Too often, the accident having so happened, such a person seeks a ‘defect’ through which to pin upon another the damage flowing from his own lapse. The frequency of that situation led one justice, during argument of an appeal, to make the ironic comment that ‘They always find it.’ ”

V.

THERE WAS NO EVIDENCE UPON WHICH A FINDING COULD BE PREDICATED THAT THE APPELLANT BREACHED ANY DUTY TO THE APPELLEE (Assignments of Error 10 through 14).

A. Assuming That the Condition of the Temple Steps Was Hazardous, Still There Was a Complete Failure of Proof With Regard to Notice of Such Condition by the Appellant.

Appellee has proceeded against appellant upon the theory that its driver, Mr. Pagay, had notice of a hazardous condition prior to June 13, 1956. Counsel for the appellee conceded that unless Mr. Pagay had such notice and that such notice was imputable, appellee's case against appellant must fail:

“The Court. What do you have to say, Mr. Ingman, as to the motion on behalf of the defendant Trade-Winds?”

Mr. Ingman. The plaintiff's case as to the defendant Trade-Winds stands or falls in my opinion on whether the notice and whether the knowledge of the driver of the cab—the notice thereby given him of the dangerous condition is notice which is binding upon the defendant corporation. I think that as far as Mr. Fleming's motion, it boils down to that one point. I would like an opportunity to submit further authorities on that point before the Court rules on it.

The Court. That was the evidence of the witness Pagay, that he saw someone slip on these steps prior to June 13, 1956, and fall?

Mr. Ingman. Yes. I think that if the Court holds that that was not sufficient notice, that notice to the driver of the tour car is not sufficient notice to the defendant corporation, then our case must fall. I believe that is sufficient notice.” (R. 250).

The answer to the question of whether the driver Pagay had notice requires a careful analysis of Pagay's testimony.

In this connection there are three questions which must be answered:

1. Did Pagay himself have notice?
2. If the driver had notice, what was it notice of?
3. Is there any evidence that such notice obtained by Pagay would be imputed to the appellant?

Mr. Pagay testified that he was hired as a taxi driver by appellant on January 29, 1956 (R. 168) and worked for about two and a half or three months as a taxi driver on the night shift before being moved to the day shift as a tour driver (R. 169). Testimony indicates that prior to the time Larry Pagay was employed by appellant, he had on many occasions taken various people to view the Temple (R. 181). Under the evidence most favorable to appellee, Larry Pagay could have been employed by appellant as a circle island tour driver for a period of only two months prior to June 13, 1956. There is no evidence to show that he was employed by appellant on the one occasion on which he testified he saw a taxi driver slip on the Temple steps (R. 177 and 170).

Pagay testified that prior to his employment with appellant he had taken various people to the Temple on many occasions (R. 181). He admitted on cross-examination that based upon his observation of the steps of the Temple, they were less slippery than

ordinary concrete steps (R. 181) and that prior to the time of appellee's fall he had no experience of any unusual nature with the steps (R. 174). He was not aware of any danger with regard to these steps until after June 13, 1956 (R. 181). At the time Pagay stated that he saw an unidentified taxi driver slip, he was far from the scene (R. 171), and he had no opportunity to determine the cause or observe the details of the incident (R. 178).

Based upon this testimony, it is reasonable to presume that at some time, which could have been prior to Pagay's employment, he had from a great distance seen someone slip on the Temple steps out of hundreds of drivers (and presumably many hundreds of guests) who drove through the Temple (R. 170). The answer to question number one then, there is evidence in the record that Pagay saw one person slip at some undetermined date prior to June 13, 1956. The mere fact that someone slipped on steps creates no presumption of any defect. *Sears, Roebuck & Co. v. Johnson*, supra.

In answer to the second question, it is conceded that at some time Mr. Pagay gained knowledge that one person at some time in the past had slipped but the cause thereof was unknown to him. The appellee's witness, the safety engineer, testified that the condition of the Temple steps was not such that an ordinary, reasonable person would be aware of any safety hazard (R. 156, 157). As stated above, the tour driver had ample personal experience with the steps to lead him to believe that they were in all respects adequate.

There are no facts in the record to support a finding that appellant knew that once upon a time an unidentified driver had slipped on the steps. In order that the knowledge of the driver be imputed to appellant, it would be necessary for the driver to have gained such knowledge while acting within the scope and course of his employment and under circumstances requiring him to communicate such knowledge to his employer.

F. W. Woolworth Co. v. Carriker, 107 F. 2d 689 (8 Cir., 1939) was an action brought by a person who slipped in the defendant's bakery. The fall was caused by slush and dirt on the floor of the bakery. A judgment on the verdict was entered in favor of the plaintiff, and the defendant appealed. The appellate court reversed and remanded the case to the lower court.

One of the questions presented was whether defendant had notice of the defect. The only evidence as to actual notice to the landowner was that one Hipp, a baker employed by the defendant, testified that he had slipped on the same spot while going to work approximately two hours and a half before the plaintiff fell. The Circuit Court held that this testimony was insufficient to prove notice on the part of the defendant.

"The evidence reveals no actual knowledge of this condition by anyone connected with defendant except Edwin Hipp. He was a baker who was employed as such in the basement where this accident occurred. He obtained his knowledge when he slipped at the same spot while

going to his place of work about five minutes before four A.M.—approximately two and one-half hours before this accident. There is no direct evidence that Hipp had any duties concerning the care of this aisle nor are such duties to be inferred from the character of his employment as a baker in another part of the basement. *McKeighan v. Kline's, Inc.*, 339 Mo. 523, 530, 98 S.W.2d 555, 559. The evidence as to actual knowledge was insufficient.” *Id.* 693.

Appellee failed to prove that Pagay was in the employ of appellant at the time of the incident, or that there was any duty on his part to report such incident to his employer. If a member of the driver's tour party had fallen then, perhaps, there would be a reasonable inference that he would be required to report to his employer and the employer would be charged with notice thereof.

“In order that an agent's knowledge may be imputed to his principal, it must have been received during the existence of the relationship, or, at least, if obtained prior to that time, it must have been present in the agent's mind during the transaction in question.” (3 C.J.S. Agency, §274, p. 206).

If the Temple steps constituted a hazardous condition, Pagay did not know about it or realize it until after the incident of June 13, 1956 (R. 18).

B. In the Absence of Contract Appellant Owed no Duty to Appellee for Injuries Sustained on Property Which Is Open to the Public and Owned and Controlled by Third Parties (Specifications of Error Nos. 10, 13, 14).

Where appellee's tour party has left the control or direction of appellant's tour driver, what duty is owed by appellant to appellee for injuries sustained upon premises which are owned and controlled by third parties and open to the public?

This case presents an unusual and somewhat unique duty relationship between the appellant tour company and its appellee passenger. Appellee purchased a Circle Island Tour ticket at a reduced rate in order to witness various tourist attractions on the Island of Oahu (R. 14). The ticket entitled appellee to transportation to and from these points of interest but did not include a guided tour through premises which are open to the public and which are owned and controlled by third parties. The customary procedure is that appellant's driver deliver the passengers to the location of interest at which time the passengers are free to make any inspection of the premises that they might desire (R. 117, 118). Eventually the tour passengers reassemble for pickup at a pre-arranged time and are transported to the next object of interest. The parties had conformed to this practice while observing the docking of the S.S. Lurline in Honolulu Harbor (R. 84 and 117) prior to visiting the Temple, and had followed this practice at the Temple (R. 118). It is customary for appellant's tour drivers to remain with their vehicles at the Temple (R. 171).

Except for common carrier cases, where the carrier either owns or controls the premises involved, or has a contractual interest in same, there are no cases which impose such a duty upon a contract carrier in the absence of active negligence. Dicta to the contrary are found in *Pierce v. Burlington Transp. Co.*, 139 Neb. 439, 297 N.W. 656 (1941) where plaintiff suffered injuries in defendant's hotel Ladies Room, while making a rest stop enroute on defendant's bus. Following *Pickwick Stage Lines v. Edwards*, 64 F. 2d 758 (10th Cir. 1933), which has similar dicta, the Nebraska Supreme Court in the *Pierce* case made the following statement at page 658:

“The Burlington Transportation Company contends that there was no negligence shown and, even if there was, that the facts are not sufficient to charge it with responsibility. The record is entirely devoid of evidence that this defendant owed any duty to the plaintiff with respect to the care of the rest room. The space occupied by the Burlington Transportation Company was rented direct from the Neville Company. The business of the Jensen Hotel Company and of the bus company were separate and distinct, the evidence affirmatively showing that no agreement, business relation or arrangement, existed between them concerning the use of hotel facilities by the Burlington Transportation Company or its employees and passengers. The record also affirmatively shows without dispute that the bus company had no right to control, maintain or care for the rest room in question. Passengers of the bus company were free to enjoy hotel privileges as any others of the public who might care to do

so. Under such circumstances no liability arises as to the bus company. *Pickwick Stage Lines v. Edwards*, 10 Cir., 64 F.2d 758 . . .”

The only analogous situation is where a passenger on a street railway is injured on a city street when walking to or debarking from a street car. Under some circumstances it has been held that the carrier is liable where a passenger is mistakenly led to alight at an extremely dangerous place which is not a usual stopping place. In *Carroll v. City of Pittsburgh*, 368 Pa. 436, 84 A.2d 505, 507 (1951), the following distinction is noted:

“ . . . In *Perret v. George*, 286 Pa. 221, 223, 224, 133 A. 228, 229, it was said by Mr. Justice (later Chief Justice) Kephart in a passage frequently quoted in later cases: ‘The hole into which appellant stepped was in the public highway, a thoroughfare over which defendant had no control, was not in any way responsible for, and had no authority to repair, if needed. However broadly and strictly we may have held street railways to care in receiving and discharging passengers, where the company owns or controls the right of way, with the approaches thereto, the rule is different where such right of way and approaches are not so owned. In the latter case there is a permissive use of the street in common with others, without any control of it. The public officers were in authority, and the municipality is responsible for the street’s condition, if an injury results therefrom. * * * It is only in exceptional cases, arising under contract, that a street railway company is responsible for acci-

dents occurring in the cartway of a street through lack of repair.”

Concededly the liability imposed upon the owner of a building for injuries suffered by invitees is not based upon title alone but upon possession and control.

In *Rouillard v. Canadian Klondike Club*, 316 Mass. 11, 54 N.E. 2d 680 (1944), a social club which hired a picnic ground was held liable for injuries to a child caused by a defective swing. The child's father had purchased a ticket from the defendant club which entitled her to enter the grounds and to use the equipment.

The Supreme Judicial Court of Massachusetts, upon consideration of an appeal taken by the defendant from an adverse judgment, dismissed the club's contention that it was not liable since it merely had the use of the picnic ground for a day, as being without merit. In doing so the Court made clear the basis for its holding:

“The jury had before them the testimony of the treasurer of the club that the club paid \$40 for which it had the use of the grounds and equipment for the day. Indeed, it was undisputed that the owner had given the club the use of the grounds for the purpose of conducting a picnic and that only those who bought a ticket from the club were to be admitted. The jury were instructed that if the club was not in possession of the grounds and had not acquired the right ‘to sell the use of these swings,’ then the club was not liable, but that if the club for a consideration

gave the plaintiff the privilege of using the swings, then it was bound to exercise care to see that the swings were reasonably safe for such use as might ordinarily be made of them. The jury must have understood that the club was not to be held responsible unless it *had possession of the grounds and equipment and that this necessarily included control over the swings . . .*" (54 N.E. 2d at 681) (Italics added).

In the case at bar appellant had no dominion or control or color of right to any control over the Temple or its surroundings. Its patrons were privileged to make use of the premises as were any members of the general public (R. 15). Appellee does not contend that she was misdirected or led into a pitfall or trap (Amended complaint, R. 4). The situation with which appellee was faced was open and apparent. (Plaintiff's Exhibit 1, R. 353, and plaintiff's Exhibit 2, R. 354).

To hold appellant responsible under the facts in the case at bar would be tantamount to making it an insurer of its patrons as to every locality at which they embarked. As an example, if this were the law, a tour company which conducted a tour through the capitals of Europe would be responsible to its patrons for the condition of each and every point of interest visited. If appellant is to be held responsible for a breach of a duty owing to appellee, such a holding would constitute an extension of liability which is not supported by law and is unwarranted and unjustified.

CONCLUSION.

There was no substantial evidence amounting to more than a mere scintilla to support the verdict of the jury against appellant as a matter of law. There was a failure upon the part of appellee to prove the existence of a condition involving unreasonable risk of harm to her person, notice of such condition on the part of appellant or the breach or any duty owing by appellant to appellee. In the interest of justice appellant is entitled to have the judgment of the lower Court reversed and a judgment entered in its favor.

It is urged that the judgment of the District Court be vacated and set aside, and that the District Court be mandated to enter a judgment for appellant, or that in the alternative the District Court be instructed to grant appellant a new trial.

Dated, Honolulu, Hawaii,
August 16, 1958.

Respectfully submitted,

WILLIAM L. FLEMING,

Attorney for Appellant, Tradewind Transportation Company, Limited, (Formerly known as Allen Tours of Hawaii, Ltd.)

Of Counsel:

SMITH, WILD, BEEBE & CADES.

(Appendices I, II and III Follow.)

Appendices.

Appendix I

Filed Aug. 1, 1958 at 1 o'clock and
30 minutes P.M.

Wm. F. Thompson, Jr., Clerk

By /s/ Thos P. Cummins,
Deputy Clerk

In the United States District Court for the
District of Hawaii

Civil No. 1535, Honolulu, T. H., July 25, 1958

Paula C. Fraser and Robert A.
Fraser,

Plaintiffs,

vs.

Matson Navigation Company, a Cali-
fornia corporation,

Defendant.

Before

Hon. J. Frank McLaughlin, Judge.

* * * * *

The Court. The motion for a new trial is denied. I do not believe that this case could be better tried a second time or that there would be any additional or better presentation of the evidence than we have had

during the trial in question. While I think there may have been errors during the trial of a legal nature, as is characteristic of all trials, for there has yet to be the perfect trial, I do not think that these errors alone warrant the granting of a new trial.

I am, however, going to grant the motion for a judgment notwithstanding the verdict. A motion for a directed verdict having been made not only at the conclusion of the plaintiff's case but at the conclusion of all of the evidence, under the provisions of Rule 50(b) the Court is allowed to make certain legal determinations with respect to questions raised by the motion after the jury's verdict, the same being deemed to be taken under advisement when during the trial it is denied, the case being, under the Rule, regarded as having been submitted to the jury subject to a later determination of these legal questions.

I am mindful in so doing that a jury's verdict is entitled to great weight and respect and to the constitutional provision that no fact determined by a jury may be retried, and I am not, in setting it aside, substituting my judgment for the jury's judgment, but I am setting aside the verdict for reasons purely of law.

I believe during the trial there were legal errors. I am inclined to believe and do believe and do hold that I erred in allowing Mr. Ebert to express an expert opinion on the subject of whether or not these stairs were safe, and thus allowed the province of the jury to be invaded, for whether or not these stairs were safe or involved an unreasonable risk of harm

was ultimately the question to be decided by the jury and was not the subject of expert opinion. As to Dr. Dodge, if his testimony stood alone as the medical testimony in this case, the jury would not have been in point of law warranted in concluding that the plaintiff's injuries were caused by the fall which she suffered in February, 1956, on the premises of the defendant, for he definitely declined to say that he entertained the opinion on the basis of reasonable medical certainty. All that he did and would say was that it could have been caused by such a fall. Possibilities are insufficient as a basis upon which to establish liability for injuries. However, Dr. Dodge's either reluctance or testimonial lack of knowledge on this all-important subject doesn't stand alone, and while I think there is error here, I don't believe that it is too serious or of the reversible variety because of the fact of Dr. Bell's testimony and the documentary testimony of Dr. Gullledge. So suffice it to say that in passing on this point as to Dr. Dodge, I simply concede that there was error as to him and I don't place too much weight on it as a ground for the action which I am taking.

Primarily I am setting the verdict of the jury aside because of insufficient evidence to support the jury's verdict with respect to the plaintiff's duty to establish that there was a failure of duty, a failure to discharge a duty owed to the plaintiff in that there is no evidence warranting the jury's conclusion that the stairs in question were in such a condition at the time in question as to involve an unreasonable risk

of harm. I am further satisfied that there is a failure of proof to establish causal connection, even assuming that there was a failure of duty, failure of proof to prove causal connection of the proximate variety, or more exact language a failure to prove that if there was a failure of the duty to the plaintiff that it was the proximate responsible cause of the plaintiff's injury. There is no question but what the lady was injured as the result of falling on these stairs and that she had suffered greatly and is still suffering, but the mere fact that she fell at the time and place in question does not in and of itself establish liability, and in the absence of proof that the stairs in question involved an unreasonable risk of harm or that, if they did, there was an inadequate warning with respect to the same, cannot provide the basis of liability.

To repeat, primarily for the reason that there was no evidence to support the jury's verdict that the defendant was negligent with respect to the maintenance of these stairs as to invitees, and because, further, if there be such assumed, there was still a failure to establish proximate causation, the verdict must be for this and other reasons recited set aside, and it is so ordered as to both plaintiffs.

ATTEST: A true copy

Wm. F. Thompson, Jr.,
Clerk, United States District Court,
District of Hawaii
By Thos. P. Cummins,
Deputy.

Appendix II

ACT 64, Series A-65, Session Laws of Hawaii, 1947, provides in part as follows:

“Section 3. Powers and Duties of Division. The division of industrial safety shall have the following powers and duties:

(a) It shall inspect places of employment and machines, devices, apparatus and equipment for the purpose of insuring adequate protection to the life and safety of workers.

(b) It shall enforce all rules and regulations made by the commission for the protection of life, health and safety of employees.

(c) It may investigate the cause of all industrial injuries resulting in disability or death which occur in any employment or place of employment, and may make reasonable orders and recommendations with respect to the cause of such injuries.

(d) It may disseminate through exhibitions, moving pictures, lectures, pamphlets and any other method of publicity, information to employers, employees and the general public regarding the causes and prevention of industrial accidents and occupational diseases and related subjects.

(e) Authorized representatives of the division shall have the right to enter any place of employment during regular working hours and at other reasonable times. [L. 1947, c. 64, s. 3.]

Section 4. Safe Place of Employment; Safety Devices and Safeguards. Every employer shall

furnish and use safety devices and safeguards, and shall adopt and use practices, means, methods, operations and processes which are reasonably adequate to render such employment and place of employment safe.

No person shall remove, displace, damage, destroy or interfere with the use of any safety device, safeguard, notice or warning furnished for use in any employment or place of employment.

No employer, owner or lessee of any real property shall construct or cause to be constructed any place of employment that is not safe, and no employer shall occupy or maintain any unsafe place of employment. [L. 1947, c. 64, s. 4.]

Section 5. Safety Orders. Whenever an investigation by the division discloses that any employment or place of employment is not safe, or that any practice, means, method, operation or process employed or used in connection therewith is unsafe or does not afford adequate protection to the life and safety of employees in the employment or place of employment, the director may make an order directing that in the manner and within a time specified such additions, repairs, improvements or changes be made and such safety devices and safeguards be furnished, provided and used as are reasonably required to render the employment or place of employment safe.

The director may, upon application of the employer or any other person affected thereby, grant such extension of time as he finds reasonably necessary for compliance with any order. [L. 1947, c. 64, s. 5.]

Section 6. Prohibition of Use. Whenever in the opinion of an authorized representative of the division the use of any machine, device, apparatus or equipment or any part thereof constitutes an imminent hazard to the life or safety of any person, a notice prohibiting the use thereof shall be attached thereto and a copy delivered to the employer or his agent. The notice shall direct the employer to show cause before the director at a time and place specified therein and not more than five days thereafter why the prohibition should not continue until the use of such machine, device, apparatus or equipment is made safe. Such notice may be disregarded if the division is notified within the time specified that the use of said machine, device, apparatus or equipment has been made safe. After hearing, the director may set aside the prohibition or continue it upon such terms and conditions as he may deem necessary. [L. 1947, c. 64, s. 6.]

Section 7. Judicial Review. An order of the director under sections 5 and 6 shall be final and conclusive against the employer unless the employer, within twenty days after a copy of such order is sent to him, files a petition for review thereof with the circuit judge of the circuit in which he resides or has his principal place of business. The filing of a petition for review shall not of itself stay or suspend the operation of such order, but a stay may be granted by the court upon terms and conditions which it by order directs. The hearing on review shall be de novo and the director shall be deemed a party to any such proceeding. [L. 1947, c. 64, s. 7.]”

Appendix III

Index to Exhibits

I Plaintiff's Exhibits

In evidence :

	<u>Identified</u>	<u>Record Pages</u>	
		<u>Offered</u>	<u>Received</u>
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No. 2	91	92	92
No. 3	115	115	116
No. 4	115	115	116
No. 5	115	115	116
No. 6	136	136	138
No. 7	148	150	150
No. 8	214	215	217
No. 9	214	215	217

II Defendant Mission's Exhibits

In evidence :

A	267	266	266
B	266	266	266

III Appellant's Exhibits

None

No. 16,033

United States Court of Appeals
For the Ninth Circuit

TRADEWIND TRANSPORTATION COMPANY,
LIMITED, (Formerly known as Allen
Tours of Hawaii, Ltd.),

Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

Appeal from the United States District Court
for the Territory of Hawaii.

BRIEF FOR APPELLEE.

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FILED

SEP 25 1958

PAUL P. O'BRIEN, CLERK



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No. 16,033

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TRADEWIND TRANSPORTATION COMPANY,
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Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

Appeal from the United States District Court
for the Territory of Hawaii.

BRIEF FOR APPELLEE.

STATEMENT OF FACTS.

The statement of fact of appellant is acceptable, so appellee will present no separate statement of facts in this brief. Appellee does, however, wish to comment on three points raised therein:

1. At the bottom of page 8 of its brief, appellant states:

“He (Pagay) stated on cross-examination that, based upon his observation of the steps at the Temple, they were ‘less slippery than concrete steps’ . . .”

Appellant fails to point out that Pagay later corrected his testimony in this regard, testifying (record, page 190) that "the tile would be more slippery" than concrete.

2. Appellant on page 9 of its Statement of Facts draws the following completely unwarranted conclusion:

"There is no evidence in the record to indicate whether at the time Pagay claimed to have seen the unidentified driver slip he was in the employ of appellant."

The record (record, pages 169 to 173) will establish that there was *ample evidence* from which to conclude that Pagay was in the employ of appellant at the time he observed the driver slip. See argument, *infra*, Section II B.

3. At page 10 of its Statement of Facts appellant states:

"The customary procedure on a tour of this type was for appellant's driver to deliver the passenger to the location where the point of interest existed."

The fact is that no "customary procedure" was established by the evidence.

SUMMARY OF ARGUMENT.

I.

No Error Was Committed by the Court in Its Rulings Upon the Admission of Evidence.

II.

There Was Ample Evidence to Support the Jury's Verdict.

ARGUMENT.**INTRODUCTION.**

Although appellant has set forth ten questions, has made ten specifications of error, and has divided its argument into five separate sections, only two basic questions are raised:

1. Did the trial court err in its rulings upon the admission of evidence?
2. Was there sufficient evidence to sustain the jury's verdict?

All the points argued by appellant were raised in its motion for judgment notwithstanding verdict to contrary and alternative motion for a new trial. The trial court gave careful consideration to all the points raised and denied appellant's motions. The trial court had a comprehensive view of the issues and of the witnesses before it and properly concluded that no error had been committed in the admission of testimony and that there was sufficient evidence to support the jury's verdict. Every negligence case turns upon its own facts, and cases cited by appellant setting forth rulings under different factual situations were properly distinguished by the trial court.

I. NO ERROR WAS COMMITTED BY THE COURT IN ITS
RULINGS UPON THE ADMISSION OF EVIDENCE.

- A. The testimony of the safety engineer as to his opinion concerning the steps in question was properly admitted.

The Territorial Safety Engineer, Mr. Ebert, testified (record, pages 125 to 130) as to his broad experience in the field of safety engineering, his membership in the American Society of Safety Engineers and his position on the executive committee of the national society.

The admissibility of Mr. Ebert's testimony was a matter within the discretion of the trial judge. See annotation in 38 A.L.R. 2d, page 13, Admissibility of Opinion Evidence as to the Cause of an Accident or Occurrence. At page 19 of this annotation it is stated:

"In some jurisdictions the admissibility of opinion evidence is almost wholly within the discretion of the trial judge. *In the federal courts this includes not only the qualification of the witness but the acceptability of his opinion as evidence.* 'There is no hard and fast rule governing the allowance of such testimony.' *Hartford F. Ins. Co. v. Empire Coal M. Co.* (1929, CA 8th Colo) 30 F2d 794." (Italics added.)

This court has followed the same rule in *Pac. Live Stock Co. v. Warm Springs Irr. Dist.*, 270 F. 555. At page 558 the court stated:

"It was for the court below to determine whether they were qualified to testify. In *Stillwell Mfg. Co. v. Phelps Railroad Co.*, 130 US 520, 527, 9 Sup. Ct. 601, 603 (32 L. Ed. 1035), Mr. Justice Gray said:

‘Whether a witness called to testify to any matter of opinion has such qualifications and knowledge as to make his testimony admissible is a preliminary question for the judge presiding at the trial; and his decision of it is conclusive, unless clearly shown to be erroneous in matter of law.’

And in *Montana Railway Co. v. Warren*, 137 US 348, 353, 11 Sup. Ct. 96, 97 (34 L. Ed. 681) Mr. Justice Brewer said:

‘It is difficult to lay down any exact rule in respect to the amount of knowledge a witness must possess; and the determination of this matter rests largely in the discretion of the trial judge.’

That rule was followed by this court in *Union Pac. Ry. Co. v. Novak*, 61 Fed. 573, 580, 9 CCA 620.”

There is sound logic and good common sense behind the rule placing admission of testimony within the discretion of the trial judge. For example in the *Taylor* case at the pretrial conference appellee advised the court that she wished to have the jury view the premises. This was objected to strenuously by the appellant since the Temple steps have been altered after the accident here involved by the application of abrasive strips. The use of abrasive strips was one of the methods of safeguarding the premises later testified to by the safety engineer as a witness for the appellee and also referred to upon cross-examination by the architect who was a witness for the appellant. The court made no ruling at the pretrial conference

but indicated that it was reluctant to allow the jury to view the premises after correction of the defect as prejudicial error might result if the change of conditions were shown. The jury might consider the applying of abrasive strips as an admission of negligence.

During the trial (record, page 246), the formal request for a view was made:

“Mr. Ingman. Your Honor, I have no further witnesses. At this time I would like to request that the jury be allowed to visit the scene of the accident to view the premises involved.

The Court. Mr. Ingman, I think in view of the evidence that is in the record and other matters about which we are aware (the application of abrasive strips to prevent slipping) that a view of the premises would not be of sufficient assistance to the jury to decide the issues in this case and might also cause a situation where the work up to date has been in vain, so the motion to view will be denied.” (Parenthetical matter added.)

The court in its reference to “a situation where the work up to date has been in vain” was obviously referring to the colloquy between court and counsel during the pretrial conference in which the subsequent application of safety abrasive strips had been discussed. The court therefore in allowing expert testimony as to the condition of the premises undoubtedly had in mind that a view of the premises by the jury might result in prejudicial error through their seeing the abrasive strips and that since the jury would be

denied the opportunity to examine the steps in the original condition without abrasive strips, expert opinion evidence should be allowed.

In the following cases expert testimony was allowed to show the condition of stairways:

McCrorry's Stores Corp. v. Murphy, 164 S. W. 2d 735;

McStay v. Citizens' Nat. Trust & Sav. Bank, 5 Cal. App. 2d 595, 43 P. 2d 560;

Goldstein v. United Amusement Corp., 86 N. H. 402, 169 A. 587;

Allison v. Doerflinger Co., 208 Wis. 206, 242 N. W. 558.

Appellant also argues that the testimony of Mr. Ebert was improper in that it invaded the province of the jury. In this connection see comment note in 78 A.L.R., page 755, on the subject, Testimony of Expert Witness as to Ultimate Facts. The following is quoted from page 757 of said note:

“The rule excluding such evidence is predicated on the fallacious theory that it invades the province of the jury. It may be noted, however, that such evidence, which the jury may believe or disbelieve, is no more binding on them than opinion evidence on the evidentiary facts from which they would find the ultimate fact. Furthermore, some ultimate facts in their inherent nature are such that the evidentiary facts to prove the same are unintelligible to any mind except that of the expert, and unexplainable to a person of ordinary experience and skill. It would, therefore, seem to be little less than useless, if not absurd, to require

the expert to testify or state his opinion as to the evidentiary facts, from which the jury would (because of the inherent nature of such facts) be unable to find the ultimate fact, and refrain from stating his opinion, the soundness of which the jury are at liberty to accept or reject, on the very fact in issue. An adherence to the rule excluding the opinion of an expert witness as to the ultimate fact confines the province of such witness largely to a statement or explanation of the scientific and technical processes by which he in his mind reaches a certain conclusion as to the ultimate fact, without stating that conclusion, and leaves to the jury the impossible task of determining that fact from premises of which they are ignorant, perhaps, even after the statements and explanations of the witness."

A comprehensive annotation on the subject here involved is found in 146 A.L.R., page 5, Safety of Condition, Place, or Appliance as Proper Subject of Expert or Opinion Evidence in Tort Actions.

It is clear in the *Taylor* case that the jury could not be expected to reach a conclusion as to the qualities of quarry tile and the degree of slipperiness caused by rain without the aid of expert testimony. The court properly exercised its discretion in allowing opinion evidence on the question of safety under the circumstances.

Other authorities are:

20 *Am. Jur.* 660 (Sec. 786).

"The determination of the question of the competency and qualifications of one offered as an

expert witness is addressed to the judicial discretion of the trial judge before whom the testimony is offered, and his ruling in passing on the qualifications of such proposed expert witness will not be disturbed unless the error is clear and involves a misconception of the law; . . .”

20 *Am. Jur.* 660 (Footnote).

“A decision that a witness is competent will not be reviewed if there is any evidence to support it. *Richard v. Prudential Ins. Co.*, 87 N. H. 31, 173 A. 375, 93 A.L.R. 784; *State v. Brewer*, 202 N. C. 187, 162 S. E. 363, 81 A.L.R. 1424.”

20 *Am. Jur.* 661 (Footnote).

“The responsibility for the exercise of the judicial power of determining whether a given witness has the qualifications which will permit him, to the profit of the jury, to state his opinion upon an issue of this kind, may best be left with the judge presiding at the trial, who has a comprehensive view of the issue and of all of the evidence, and the witness himself before his face. *Turner v. American Secur. & T. Co.*, 213 U. S. 257, 53 L. ed. 788, 29 S. Ct. 420.”

Appellant appears to place great weight (Appellant's Brief, pages 30 and 31) upon a recent *unreported* decision of Judge McLaughlin in *Fraser v. Matson Navigation Company*, and appends a copy of Judge McLaughlin's oral decision to its brief. It is trite to state again that each case depends on its own peculiar facts. Since the facts are not stated in the opinion and are not of record here this court can find no assistance from the decision. To appellee's knowl-

edge (hearsay) the factual situation in the *Fraser* case was not comparable to the *Taylor* case and no issue was involved as to the effect of water upon the material from which the steps were made.

Appellant at pages 31 to 35 of its brief attempts to set up certain technical requirements which must be met before expert testimony is permissible on the question of safety. Actually the law does not require technical matters such as evidence of standards of custom and usage prevailing in the community. As stated at page 6 in the 146 A.L.R. annotation:

“Broadly speaking, the rule is that a witness possessing special skill in drawing inferences from data furnished by others or from personal observation and investigation may express his opinion whenever the facts are such that inexperienced persons are likely to prove incapable of forming a correct judgment without such assistance, and that a nonexpert or lay witness may express his opinion where, from familiarity with or personal observation of the subject matter, he has gained a personal knowledge existing in reason rather than facts, which cannot otherwise be fully presented to the jury.”

Under the circumstances present in the *Taylor* case the court properly exercised its discretion in allowing the opinion of the Territorial Safety Engineer as to the use of quarry tile on exterior steps. It is significant to note that at *appellant's request* the court gave appellant's requested instruction No. 6 (record, pages 20 and 21) *advising the jury that it was not bound by opinions of experts*. Clearly no error and certainly no

prejudice in view of this instruction resulted from the admission of this expert testimony.

B. No error resulted from the questions asked of the witnesses Lester and Pagay.

The question asked of the witness Lester (Appellant's Brief, page 35) was stricken and the jury was instructed to disregard the question and the answer. It is clear that no prejudicial error occurred. Certainly appellant has not pointed out in its brief how a ruling in its favor could prejudice it.

The argument of appellant on the question asked of the witness Pagay (Appellant's Brief, page 37) is likewise without merit. The witness was uneducated and did not seem to have a good understanding of the English language. Under these circumstances it would appear reasonable and necessary to pinpoint the questions put to the witness. How was appellant possibly prejudiced? Also, the question was asked to clarify testimony of the witness regarding matters contained in a written statement which counsel for appellant declined to produce on the ground it was his own work product. Under these circumstances the court properly exercised its discretion in allowing the question involved.

The duty is on appellant to show not only that there was error but also how these questions prejudiced appellant. Appellant has not so shown.

II. THERE WAS AMPLE EVIDENCE TO SUPPORT THE JURY'S VERDICT.

A. There was substantial evidence that the steps presented an unreasonable risk of harm to appellee.

Appellee concedes that the mere fact she fell on the steps creates no presumption in her favor. However, there was substantial evidence of the existence of an unsafe condition and if there was conflicting evidence the jury had a right to select the evidence it believed more credible. The following abstract of the testimony of Territorial Safety Engineer Ebert (record, page 135) establishes a sufficient basis for the jury's verdict:

"Q. (By Mr. Ingman.) What are the qualities of quarry tile, if you know?

A. The qualities of quarry tile are such, being a hard surface tile, from the safety standpoint will contribute to slips and falls because of the very nature of the tile, particularly when it is wet."

At page 148 he was asked:

"Q. (By Mr. Ingman.) Do you have an opinion as to the proper methods of safeguarding the use of this type of tile under the conditions present at 1708 Nuuanu Avenue?

A. Yes, I do."

...

"A. My opinion is that any stairway built of the materials used must have an anti-slip treatment given, put on, or they shouldn't use it on the stairs."

...

"A. Particularly outside where it is exposed to weather, rain,

Q. And what do you call this treatment?

A. The treatment is such as I have here. This is an all-weather abrasive stripping with an adhesive back. (Showing a piece of abrasive material.)

Q. And where should that be applied?

A. It should be applied to the nosing of the stair. That is, up the front portion."

Mr. Ebert further testified (record, pages 155 and 156):

"Q. (By Mr. Ingman.) Now, Mr. Ebert, with regard to this condition which existed at 1708 Nuuanu in June of 1956, are there any other methods of safeguarding the premises, were there any other methods of safeguarding the premises in your opinion?

A. Yes, there were.

Q. Would you state the method or methods?

A. The accepted method would be the installation of a hand rail."

• • •
 "Q. (By Mr. Ingman.) Showing you exhibit 1, where in your opinion would have been the correct place to install a railing in June of 1956?

A. There are three locations. There should be a railing on each side and down the center because of the width of the stairway.

Q. That would be a single railing in each of those three places?

A. A single or double in the center and a single on each side."

Mr. Pagay testified (record, page 190):

"Q. (By Mr. Ingman.) With reference to the concrete and tile at 1708 Nuuanu Avenue, which do you believe to be more slippery?

A. The tile would be more slippery."

Appellant's expert witness, architect Lester, was asked on cross-examination (record, pages 278 and 279):

"Q. Now, as to the use of abrasives with quarry tile, Mr. Lester, would it be correct to say that the use of quarry tile on outside unprotected areas would be preferable to the use of quarry tile without abrasives?"

...
"Q. Well, with specific reference to quarry tile under wet conditions, might this type of abrasive render it safer for use?

A. Under certain conditions it might.

Q. Well, the conditions I am speaking of are outside conditions where the tile becomes wet.

A. I think it would, yes."

Again (record, page 282) Mr. Lester testified:

"Q. Now, I asked you whether there was any other method other than Plaintiff's Exhibit 7?

A. I know of no other method, unless they add a cement mixture in the tile when they make it.

Q. That is a so-called built-in abrasive?

A. That is correct.

Q. That would render quarry tile less slippery under wet conditions, would it not?

A. If it had a built-in abrasive?

Q. Yes.

A. Yes, it would."

Obviously there was sufficient evidence of a condition presenting unreasonable risk of harm to appellee.

B. There was substantial evidence of knowledge of the defective condition on the part of appellant.

The testimony of appellant's tour driver, Pagay (record, page 169 and following), establishes the fact that his testimony as to a prior slip or slips on the stairs related to the period during which he was in appellant's employ.

“Q. And when did you start driving as a guide for tours?

A. I think I started about the middle part of April or the early part of April, if I am not mistaken.

Q. 1956?

A. '56.

Q. And during the time that you accompanied the other tour drivers and the time that you drove your own tour, did you stop at the Soto Mission, 1708 Nuuanu Avenue?

A. Correct. We stopped.

Q. And how often during the period from April to June, 1956, would you say you visited those premises?

A. Well, it was a pretty busy month. I think it was a week at least.

Q. And did you ever visit those premises when it had been raining?

A. Yes, sir, many times.

Q. Now, prior to June 13, 1956, had you visited the premises when they were wet?

A. You mean on that date?

Q. Before June 13, had you visited the premises when they were wet?

A. Yes, sir.

Q. What did you observe on these prior occasions that you had visited the premises when the steps were wet?

A. Well, I was fairly new then. I didn't know very much about tours, about telling people to be very careful, until after the accident what Mrs. Taylor had. And ever since then I was very careful about telling people to watch their step when they get off the car or going into buildings.

Q. But going back to the time before her accident, what did you see happen on these days you visited the mission when the steps were wet?

A. I think a few times I myself seen some of the drivers—I can't tell who they are because we have hundreds of them go through the temple—they go outside, independent cabs because we have lots of boats coming in the past couple of years.

Q. You saw some of the drivers what?

A. Slip, not accidentally fall on their back, but just slip and to break their fall they would use their hands."

It is obvious from Pagay's statement, "Well, I was fairly new then," that he is referring to occurrences during the course of his employment with appellant.

Pagay went on to testify (record, pages 172 and 173):

"Q. Now, it still isn't clear to me whether the two or three people you saw fall, that you say you saw fall on those steps were all drivers or part or whether there was one driver and one tourist or other type of person. Would you clarify that?

A. Well, I can't say, sir, because like I said, I seen a lot of drivers up there and people that go on a tour, and I seen them actually slip.

Q. Well, now, what do you mean by 'slip'?

A. Well, coming down the stairways, I'd say they would miss the balance or, you might say,

misbalance and just have the shoes at the end of his heel that would slip and he would get himself unbalanced so he just fall on his side. He use his hands then for a brace."

. . .

"Q. (By Mr. Ingman.) Just how did the people you observe fall, if there were more than one way of falling, describe the separate types of falls which occurred.

A. You would like me to answer that, sir?

Q. Yes.

A. Well, actually, I seen one of the drivers fall sideways. I won't say fall from his back but slip and misbalance sideways. A man would be on his left——

Q. How did he land?

A. With his hands, sir. He had his hands as his protection. I mean his brace, I would say."

It is well established law that *knowledge of the employee is knowledge of the principal when obtained during the scope of his employment*,¹ Restatement of Agency, Sec. 232. In the first example given in that section, an employee who failed to warn an adjoining landowner of a fire breaking out on premises being guarded by the employee was held to be acting in the scope of his employment. His failure to warn the adjoining landowner was held to render his principal liable to the landowner to whose premises the fire spread. The California, Massachusetts and Michigan annotations follow the rule of Sec. 232.

A case very close to the *Taylor* case is *Teche Lines v. Keyes*, 193 S. 620, 187 Miss. 780, which is the subject of an annotation at 126 A.L.R. 1084. In the *Teche*

case a passenger on a motorbus was injured as a result of the defective condition of a roadway owned by a government agency. The defective condition consisted of a soft spot in the road at a particular location, the existence of which was unknown to the driver of the bus on the date in question. However, another driver of defendant bus company testified that he had learned of the dangerous place and made a practice of veering to the center of the road to avoid it. The court held that the discharge of the highest degree of care consistent with the practical conduct of the business of the bus company required that it secure reports of road conditions from its drivers to be passed along to drivers using the same route, *overruling the contention of the bus company that it had no knowledge of the defective condition and in any event could not be liable for the defective condition of another's property*. In the *Taylor* case we have much stronger evidence from the plaintiff's standpoint. As in the *Teche* case the dangerous condition of another's property is involved but instead of the knowledge of another driver of the tour company, we *have the knowledge of the same driver* who was in charge of the tour on the date of the accident.

F. W. Woolworth Co. v. Carriker, 107 F. 2d 689 (C.C.A. 8th 1939), cited by appellant at pages 38 and 39 of its brief, can be distinguished. That case involved a temporary dangerous condition resulting from a wet floor, a different type of case from *Taylor*. The holding of the *Woolworth* case is that knowledge of a slippery condition acquired shortly before the accident by a baker employed by defendant was not

obtained during the course of his employment as he had observed the condition while passing through the premises before dawn en route to the department in which he was employed. This situation is distinguishable from that involving a tour driver *in charge* of a tour party. The most common method by which a tour company would acquire knowledge of the dangerous condition of premises visited by its tours would be through the observation of conditions by the drivers while actually conducting the tours and escorting patrons to places of scenic interest.

The jury by its verdict found that Pagay learned of the condition within the scope of his employment. The trial court in passing upon appellant's motions before and after the verdict found there was sufficient evidence of this fact.

Whether the agent was acting within the scope of his authority or employment was a question of fact for the jury. 2 *Am. Jur.*, Agency, Sec. 454, states the law as follows:

“It is the settled, general rule that the question of the scope and extent of the agent's authority is to be decided from all the facts and circumstances of the evidence, *and is to be determined by the triers of the facts.*” (Italics added.)

- C. The fact that the injury occurred on property owned by a third person does not relieve appellant from its liability for failure to warn of the dangerous condition.**

The general rule with regard to the liability of a carrier for injuries occurring on premises not owned or controlled by the carrier is set forth at 10 *Am. Jur.*, Sec. 1288:

“With respect to the liability of a common carrier of passengers for injuries caused by defective premises not owned or controlled by the carrier, the general principle has often been applied that one who, *although not strictly in control of a defective agency or dangerous place, uses it for his own benefit or for his own purposes and invites another to make use of the same may be held liable to the latter for an injury caused by the defect or danger.*” (Italics added.)

An annotation on one phase of this subject is found at 41 A.L.R. 2d 1286. At page 1305, Sec. 10 thereof, are listed five cases recognizing the liability of a bus company for injuries to passengers at stations along its route notwithstanding the lack of ownership of the premises involved by the bus company and notwithstanding its lack of knowledge of the dangerous condition. Related cases are *McBroom v. Greyhound Lines*, 193 S. W. 2d 92 (bus passenger injured on property not owned by bus company), and *Watts v. Colonial Stages*, 163 S. E. 523 (incorrect directions as to location of restroom located on premises not owned by bus company). Related annotations are 9 A.L.R. 2d 938, 946 (condition of place where passenger discharged), 35 A.L.R. 757 and 61 A.L.R. 403 (passenger temporarily leaving train) and 33 A.L.R. 820 (detour—condition of station of another carrier).

Horelick v. Pennsylvania Railroad Company, 13 N. J. 349, 99 A. 2d 652 (1953), is a leading case. In a unanimous opinion the court held that the liability of a railroad company after completion by plaintiff passenger of his journey exists, notwithstanding that

the injuries were received by the plaintiff after alighting from the train *on an icy platform neither owned nor controlled by the defendant company.*

A point which should be emphasized in connection with cases holding a carrier liable for injuries received by passengers on another's property is that *the great majority of these cases do not even consider the issue of knowledge on the part of the defendant carrier or its employees.* In other words the basis of liability is that the carrier owes a high duty to its passengers and is therefore liable for any condition of which it knew or should have known. On the other hand the appellee in the Taylor case did not urge at trial such an extensive liability to exist on the part of appellant but submitted the matter on a theory more favorable to appellant, simply on the question of actual knowledge of the appellant or its authorized employee.

Hotels El Rancho, Inc. et al. v. Pray, 187 P. 2d 568, 64 Nev. 591, a *non-carrier* case, emphasizes this distinction. From a plaintiff's standpoint *Pray* is not as strong a case as Taylor, since there was no evidence there of actual notice of the dangerous condition on the part of defendant or its employees. Notwithstanding the fact that the defendant in the *Pray* case was not a carrier, the legal principles involved are strikingly similar to those involved in the Taylor case.

In the *Pray* case the plaintiff sued Hotel Last Frontier and others to recover damages for the death of plaintiff's son in a cross-country race. The jury brought in a verdict against the Hotel Last Frontier

who raised the point on appeal of lack of ownership of the premises where the injuries occurred. The owners of the Hotel Last Frontier had for some time prior to the date of the accident been promoting cross-country races for the purpose of advertising the hotel. They contended that they had no contractual or other relationship with the owner of the property and were themselves *trespassers* against the true owner on the date of the accident. The court held that the owners of the Hotel Last Frontier had invited the deceased onto the premises and therefore owed a duty to warn of defects of which they knew or should have known. There was no evidence that the defendants or their employees knew of the dangerous condition and there was strong evidence from which the jury could have concluded that the deceased was in a better position to learn of the dangerous condition than the defendants. However, notwithstanding their *lack of knowledge of the dangerous condition*, defendants were held liable. The holding of the *Pray* case is merely a logical application to a non-carrier case of the holdings of the numerous cases in which carriers have been held responsible for injuries to passengers on another's property, notwithstanding lack of actual knowledge on the part of the carriers or their employees.

It therefore appears reasonable that under the majority rule applied in the carrier cases, and in the *Pray* case, appellee could have obtained an instruction by the court in the Taylor case that the appellant could be liable if it knew or *should have known* of

the dangerous condition. Since appellee did not request such an instruction appellant cannot complain. *The court's instructions on the liability of the appellant as given were therefore favorable rather than prejudicial to the appellant.* (See record, pages 39 and 40.)

The *Pray* case is cited favorably in *Watford v. Newspaper Co.*, 211 F. 2d 31, a case involving injury to spectators at a soap box race held on public property.

Another case in point is *Zerner v. Cohen*, 87 N.Y.S. 2d 342. The plaintiff's action in the *Zerner* case was against a husband and wife. The husband was the owner of the property where the dangerous condition was alleged to exist. The trial court dismissed the action as to the defendant wife on the ground that only the owner of the premises could be liable for the defective condition. On appeal the court reversed, holding that the issue of the wife's liability for failure to warn should have been submitted to the jury since liability did not depend on ownership of the property.

Appellant at page 52 of its brief emphasizes certain language re possession and control from *Rouillard v. Canadian Klondike Club*, 54 N. E. 2d 680. In the *Rouillard* case there was no evidence that the defendant had used the premises previously, no evidence that the defective condition existed prior to the date of the accident and no evidence of any knowledge of the defective condition on the part of the defendant prior to that date. The case is clearly distinguishable from *Taylor*. The same is true as to the *Pierce* and *Pick-*

wick cases (page 50, Appellant's Brief). In neither of these cases was there any evidence of notice to defendant or its employees of any dangerous condition.

Collins v. Hazel Lumber Co., 103 P. 798, 54 Wash. 524, is another holding consistent in its reasoning with the *Horelick* and *Pray* cases. The court stated at 103 P. 800:

"The mere fact that the appellant was a trespasser as to the owner of the land, or that persons traveling over the way were trespassers as to the true owner, did not make such persons trespassers as to appellant. As between the appellant and persons lawfully upon the highway, the appellant, under the conditions shown, was as clearly liable to his invitees as though it owned the land. *This proposition is elementary. After appellant has invited persons upon premises not its own, it cannot be heard to say to its invitees, who did not know the facts, 'I had no legal right to invite you there, and am therefore not liable for my negligence in not maintaining a reasonably safe place for you.'*" (Emphasis added.)

CONCLUSION.

The facts of every negligence case are, of course, different, and each case must be decided upon its own peculiar facts. The basic principles of law upon which the instant Taylor verdict should be sustained are that:

1. It is negligence not to warn persons of *known defects and dangerous conditions*.

2. The knowledge of an employee of a known defect and dangerous condition obtained within the scope of his employment is the knowledge of his employer.

As stated, the basic issue before this court is whether there was *sufficient evidence*, more than a mere scintilla, *to justify the verdict*. Appellee believes that the evidence was not only sufficient but in many respects conclusive. The issue of the existence of a dangerous condition was submitted to the jury on conflicting evidence and appellant should not now be permitted to argue that there was no evidence of a dangerous condition. The prior knowledge of appellant's employee, Mr. Pagay, obtained during the course of his employment on a previous visit to the temple, was submitted to the jury for its consideration. The jury by its verdict found that this employee had learned of the dangerous condition *in the course of his employment*. The other element of appellee's case, failure to warn, was admitted by the tour company.

The court completely and correctly submitted to the jury the issue of the liability of the tour company (appellant) to Mrs. Taylor (appellee) (record, pages 39 and 40 and page 24):

“If you find by a preponderance of the evidence that a condition involving an unreasonable risk of harm existed at 1708 Nuuanu Avenue on June 13, 1956, that defendant tour company's employee learned of said condition in the course of his employment prior to that date but failed to warn plaintiff, and that said condition was the

proximate cause of plaintiff's injury, then you should find for the plaintiff and against defendant tour company, irrespective of what you may find as to the liability of defendant mission."

"The defendant's, Allen Tours of Hawaii, Ltd., only duty to the plaintiff with regard to the steps of the Soto Mission did not constitute a hazard—the plaintiff of the existence of a dangerous condition known to defendant Allen Tours of Hawaii, Ltd., or its authorized employee and unknown to the plaintiff. If you find that the steps of the Soto Mission on June 13, 1956, was to warn of dangerous condition, then your verdict must be for both defendants.

"Before you may find against the defendant Allen Tours of Hawaii, Ltd., you must find that hazardous condition existed, that said defendant or its authorized employee had actual knowledge of the condition, and that the condition was not apparent to a reasonably prudent person observing the same. If defendant Allen Tours of Hawaii, Ltd., had no knowledge of this condition, or if the condition was apparent to a reasonably prudent person, then you cannot render a verdict in favor of the plaintiff against the defendant Allen Tours of Hawaii, Ltd."

Under the authorities cited this was a proper statement of the law; under the evidence the jury was justified in finding and must have found that a dangerous condition existed, that an authorized employee of appellant had learned of that condition in the course of his employment prior to the date of the accident, and that he had failed to warn appellee of

said condition. The trial judge after extensive arguments and review of all the facts came also to this conclusion in denying the motion for judgment notwithstanding the verdict to contrary and alternative motion for a new trial.

The judgment should be affirmed.

Dated, Honolulu, Hawaii,

September 24, 1958.

Respectfully submitted,

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No. 16,033

United States Court of Appeals
For the Ninth Circuit

TRADEWIND TRANSPORTATION COMPANY,
LIMITED, (Formerly known as Allen
Tours of Hawaii, Ltd.),

Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

Appeal from the United States District Court
for the Territory of Hawaii.

REPLY BRIEF FOR APPELLANT
TRADEWIND TRANSPORTATION COMPANY, LIMITED
(Formerly known as Allen Tours of Hawaii, Ltd.).

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VS.

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**Appeal from the United States District Court
for the Territory of Hawaii.**

**REPLY BRIEF FOR APPELLANT
TRADEWIND TRANSPORTATION COMPANY, LIMITED
(Formerly known as Allen Tours of Hawaii, Ltd.).**

INTRODUCTION.

Appellant, in this reply brief, will refrain from repeating the arguments heretofore set forth in its opening brief. Appellant will deal briefly with the new points which have been raised by appellee and certain factual allegations in appellee's brief which seem in need of correction or amplification.

ARGUMENT.

I. THE DISTRICT COURT ERRED IN ALLOWING OVER OBJECTION TESTIMONY OF THE SAFETY ENGINEER.

- (a) The question with regard to the testimony of the safety engineer is not whether the District Court abused its discretion in ruling with regard to the qualifications of the witness as an expert but rather whether assuming the qualification of this witness as an expert the Court erred in allowing him to testify as to his opinion of safety.

Appellee seeks to justify the testimony of the safety engineer upon the basis of facts not appearing of record in this case (Appellee's brief, pp. 5 and 6). Appellee states that at the pretrial conference it was brought to the attention of the Court that the temple steps had been altered after the accident by the application of abrasive strips. Since the appellee has chosen to go off the record, in order to be fair in so doing, there should have been a complete disclosure of what occurred at the pretrial conference. This was not done.

At the pretrial conference held on November 5, 1957 (R. 67) it was brought to the attention of the Court that shortly before the pretrial conference defendant Soto Mission had placed abrasive strips on its temple steps. The Court was also made aware of the decision of the Supreme Court of the Territory of Hawaii in the case of *Pow Kee v. Wilder S.S. Co.*, 9 Haw. 57, 60 (1893) wherein the Supreme Court of Hawaii adopted the holding of the United States Supreme Court in *Columbia & P.S.R. Co. v. Hawthorne*, 144 U.S. 202, 36 L.Ed. 405, to the effect that the evidence of changes made in premises after an accident are inadmissible as evidence of negligence since the taking

of such precautions against the future is not to be construed as an admission of responsibility for the past and has no legitimate tendency to prove that the defendant had been negligent before the accident happened.

It is interesting to note further that the appellant on November 5, 1957, the date of the pretrial conference, and the day before the trial (R. 67) amended her complaint by striking the allegation that the steps in question had been improperly chipped and substituted therefore an allegation that the steps "had not been safeguarded with abrasive strips" (R. 4).

Appellee is correct (Appellee's brief p. 6) when she states that the Court was reluctant to allow the jury to view the premises as prejudicial error would have resulted if the change of conditions were shown. It was this belief of prejudicial error on the part of the Court which led the Court to remark that a view of the premises "might also cause a situation where the work to date had been in vain" (R. 246, Appellee's brief p. 6). It is difficult to conceive how this situation would have any bearing on the admissibility of testimony of the safety engineer.

In arguing the question (Appellee's brief pp. 4 through 10) as to the propriety of the testimony of the safety engineer, appellee sets forth many cases and quotes from cases and texts. A careful examination of the authorities, save and except those set forth at p. 7 of appellee's brief, will indicate that these authorities stand simply for the proposition that it is largely within the discretion of the trial court to de-

termine whether a witness has such qualifications and knowledge so as to allow him to testify as an expert and give his opinion on certain matters. For example, in the case of *Turner v. American Security & T. Co.*, 213 U.S. 257, 53 L.Ed. 788, a quotation from which is found at page 9 of appellee's brief, the sole material issue applicable to the case at bar was whether in a case involving a Will contest, it was error to allow a lay witness who had had an adequate opportunity to observe the speech and other conduct of the testator whose soundness or unsoundness of mind was at issue, to state his opinion upon the issue of mental capacity. In other words, there was no question but that the type of evidence to be elicited from this witness was proper, the only question being whether the trial court properly exercised its discretion with respect to the *qualifications* of the witness to give his opinion in this respect.

With the exceptions as noted, all of the appellee's cases deal with the discretion of the trial court with respect to the qualifications of a witness as an expert rather than the type of testimony that the witness may give after he has been qualified as an expert.

Appellant is not complaining of the action of the District Court in its ruling with regard to the *qualifications* of the witness Ebert. The errors urged by appellant are the rulings of the District Court with respect to the *subject matter* of this witness' testimony.

(b) The authorities relied upon by appellee sustain the appellant's position that the testimony of the safety engineer was improperly admitted.

Appellee cites four cases on page 7 of her brief. Appellee states that in those four cases expert testimony was allowed to show the condition of stairways. Examination of those cases will show that each of them support the position taken by appellant.

In *Goldstein v. United Amusement Corp.*, 86 N.H. 402, 169 Atl. 587 (1933), the Court held that it was not error to allow an expert to testify that the construction of stairs was not proper and supplemented his opinion with an enumeration of specific defects.

In the case of *McCrorry's Stores Corp. v. Murphy*, 164 S.W.2d 735 (Tex. App. 1942), an architect was allowed to testify as an expert. He examined and measured the steps and stated they were made of terrazzo and that this substance was in common use in such structures. He said the steps had been used 20 to 25 years and showed signs of wear and that they did not incorporate many of the safety measures considered necessary in more modern structures.

A reading of this decision will indicate that there was no question of the propriety of this testimony nor any indication that it had even been objected to. The only contention to be made on appeal by the appellant in that case was that the verdict was so overwhelmingly contrary to the evidence that it should be set aside.

In *McStay v. Citizens' Nat. Trust & Sav. Bank*, 5 Cal.App.2d 595, 43 P.2d 560 (1935), the appellant

complained of the trial court's ruling in admitting the testimony of two experts with respect to the construction and safety of the steps and platform. An architect was allowed over objection to testify that the steps were not scientifically constructed in that first they were unnecessary in the place where they were located, and secondly, that they had no guard or hand-rail for people to hold on to.

In addition, a safety engineer was permitted, over objection, to give his opinion as to whether or not the steps, as he saw them, were safe or unsafe.

The Court (43 P.2d at p. 563) stated that it was proper to allow testimony concerning the scientific or customary construction of the steps in a hotel building since it was not a matter of common knowledge. The Court stated that in view of the answer of the safety engineer considered in connection with other proofs in the case, they deemed *the error* in overruling the objection to the question to him harmless.

The remaining case cited by the appellee on page 7 of her brief is *Allison v. Doerflinger Co.*, 208 Wis. 206, 242 N.W. 558, 560 (1932). In that case the defendant appealed from an order granting the plaintiff a new trial. It appeared that the plaintiff had been injured in a fall on the defendant's steps. The plaintiff brought action for damages based upon a violation by the defendant of the "Safe Place Statute" of Wisconsin and a violation of orders of the Industrial Commission.

The lower court had excluded expert testimony as to whether the steps had reasonable and adequate safety devices and as to whether they (the steps) conformed to the requirements of the Industrial Commission's rules and regulations that had been offered in evidence. The Appellate Court affirmed the order granting a new trial and by way of dicta stated that such testimony should have been allowed.

The aforementioned case standing alone might have been considered as authority for the appellee's position had the claim of the plaintiff been based upon the general law of negligence rather than a statutory action for violation of a State law and specific orders of the Industrial Commission.

In *Bent v. Jonet*, 213 N.W. 635, 252 N.W. 290, 293 (1934), the Supreme Court of Wisconsin in referring to the case of *Allison v. Doerflinger Co.*, supra, pointed out that the basis of the decision in the earlier case allowing expert testimony as to the safety of the structure involved was that the orders of the Industrial Commission had been introduced in evidence and it was, therefore, proper to offer expert testimony to explain these orders and to explain whether or not the situation as it existed, complied with the law and the orders which had been introduced in evidence. The Court (252 N.W. at p. 293) rejected the contention that the case of *Allison v. Doerflinger Co.*, supra, laid down any rule that expert testimony would be receivable if the matter related to skill or science even though the ultimate question before the jury was passed upon.

In the case at bar there was no evidence of any law, rule or regulation applicable to the steps at the Soto Mission Temple on June 13, 1956. This fact was recognized by the Court (R. 285-287).

From the foregoing it is apparent that the appellant has failed to cite any specific authority to the effect that a safety expert may testify as to an ultimate question of fact to be determined by the jury. It would appear that there is no such authority and that the law is well-established to the contrary.

II. EVIDENCE RELIED UPON BY APPELLEE OF THE EXISTENCE OF A DANGEROUS CONDITION IS INSUFFICIENT AS A MATTER OF LAW TO ESTABLISH SUCH A CONDITION.

The evidence relied upon by appellee supports a finding that there was a dangerous condition at the Soto Mission Temple on June 13, 1956, is set forth verbatim on pages 11 through 14 of appellee's brief. Summarized, this evidence consists of testimony of the safety engineer, defendant Soto Mission's expert witness, the architect Mr. Lester, and testimony of the tour driver.

A major portion of the testimony of Mr. Ebert (R. 135, 155 and 156) relied upon by appellee was objected to by appellant and is found in Specifications of Error No. 2 (appellant's opening brief, p. 14) and No. 6 (appellant's opening brief, p. 18). If this testimony was erroneously admitted, it follows that it must have been prejudicial since appellee herself relies upon it as a basis for the finding of the existence of a hazardous condition.

Assuming, for the sake of argument, that the District Court did not err in admitting this testimony of the safety engineer, nevertheless his testimony cannot form the basis of a finding of a hazardous condition. This expert himself testified: "Q. (by Mr. Knight): I see, so that was an ultimate—and, as you say, these are a high degree of professional standards of safety? A. Absolutely." (R. 159-160). "Q. (by Mr. Knight): Mr. Ebert, would a reasonably prudent person as opposed to a safety engineer be aware of any safety hazard that would be present in June of 1956? A. Would be aware of it? Mr. Ingram. I object to the question. The Court. Objection overruled. A. I don't think so." (R. 156-157).

In other words, it is apparent that the standards testified to by Mr. Ebert were optimum standards of the highest degree as established by safety engineers.

The testimony of the architect relied upon by appellee (appellee's brief, p. 14) does not assist her case. The architect merely acknowledged on cross-examination that the steps could have been further improved. The fact that the steps could have been better than they were is not material unless it is first established that they were substandard and that additions were required to bring them up to recognized standards. *Pow Kee v. Wilder S.S. Co.*, 9 Hawaii 57, states at page 59:

"... In this particular case, for instance, it may not have been negligence to have continued the use of a wooden warehouse built some years ago under circumstances which made it proper to erect such a building. A person is not obliged to

pull down an expensive building and erect another whenever he can erect a better one. . . .”

III. APPELLEE'S CONTENTION THAT THERE WAS EVIDENCE OF APPELLANT'S KNOWLEDGE OF A DEFECTIVE CONDITION IS WITHOUT BASIS IN LAW OR IN FACT.

Appellee has set forth the rule of law that the knowledge of an employee gained within the course and scope of the employment is imputed to his principal (Appellee's brief, p. 17). We accept this statement of law as being correct but there should be added to it the qualification that the knowledge must be with regard to a subject matter connected with the employment.

Appellee has cited at length from the record (appellee's brief 15 through 17) portions of the testimony of appellant's former employee Pagay dealing with his having at one time seen a man slip. From this testimony appellee draws the unwarranted conclusion that the occasion on which appellant's former employee saw a man slip must have related to the period during which he was in appellant's employ. It is submitted that the burden of proof was on appellee to prove this point and counsel for the appellee so acknowledged (R. 250) (Appellant's opening brief p. 44).

In quoting from the Record the testimony of appellant's ex-employee, appellee ignores a pertinent part of the testimony referring to the time when this occurrence is alleged to have occurred. In the cross-examination the tour driver testified as follows:

“Q. (By Mr. Fleming): Now, then, you testified, I believe, as to seeing a driver slip, is that right? [268]

A. Correct.

Q. Do you know his name?

A. No, I don't, sir.

Q. Do you know when it was?

A. Well, I can't say what time it was, sir, and what date.

Q. Now, isn't it a fact that he is the only man you ever saw slip on these steps?

A. That is the only man, yes.

Q. Did you see a woman?

A. I seen a woman, not on the steps but on the grass.”

“Q. (By Mr. Fleming): You have been up the steps in the temple there how many times would you estimate from the period prior to June 13, 1956?

A. Before that, you mean to say?

Q. Yes.

A. I can't count. Many times.

Q. Many many times?

A. Yes, even before I was a driver I still went up there to show people.

Q. You are still going up now?

A. Still going.” (R. 177 and 180-181).

Appellee relies upon the case of *Teche Lines v. Keyes*, 193 S. 620, 187 Miss. 780 (1940) (appellee's brief, p. 17) as being in point and supporting the position taken by the appellee. It is submitted that this case is not authority for the position taken by appellee and is clearly distinguishable. That case

arose out of an accident to a passenger of a common carrier while the common carrier was in transit.

The Court in the *Teche* case held that a common carrier was under the highest degree of care with regard to the carriage of passengers along its route and that by reason thereof practical conduct of its business required that reports be made by its driver with respect to dangerous places occurring along the route (193 S. 620 at 622). In the *Teche* case there was no dispute as to the existence of a dangerous condition and actual knowledge and notice of such condition by drivers other than the one involved in the accident whereas in this case there is no evidence that anyone, including the witness Pagay had any knowledge of any hazardous condition. The very existence of a hazardous condition was in dispute.

The Court asked the witness Pagay if he had ever had any experience of an unusual nature on the steps himself to which he replied: "No, sir." Appellee's counsel asked him what his experience had been with regard to these steps prior to June 13, 1956, to which he replied: "No experience at all." (R. 174).

Thus, appellee is arguing that even though there was nothing to give notice of a hazardous condition to appellant's former employee, the tour driver, nevertheless since an expert might later determine that there were in fact hazards, that subsequent determination would relate back to give notice to the one to whom the defects were not and should not have been apparent. It is submitted the argument is fallacious

and that there is no evidence in the case at bar of the notice of a hazardous condition to anyone.

IV. THE CONTENTION THAT APPELLANT OWED APPELLEE A DUTY TO NOTIFY HER OF THE CONDITION OF THE MISSION STEPS IS WITHOUT BASIS WHEN CONSIDERED IN RELATION TO THE FACTS IN THIS CASE.

Heretofore appellee has not contended that appellant is a common carrier. The facts indicate that appellant was a private carrier and that appellee paid a reduced fare as a member of a private tour party, which tour was not open to the public (R. 295). This is not the case where a common carrier has adopted the premises of another (e.g. depot facilities furnished pursuant to a contract with a third party) to fulfill his contract of carriage nor is it contended that appellant had a non-delegable duty to provide means of ingress and egress into the Soto Temple as is the case of common carriers which adopt the depots with facilities of another carrier in execution of its contractual duties. (See 41 ALR 2d 1286, at p. 1290).

At page 20 of appellee's brief, appellee cites two cases for the proposition that appellant owed a duty to appellee to notify appellee of the defect in the Mission steps. In *McBroom v. S. E. Greyhound Lines*, 29 Tenn.App. 13, 193 S.W. 2d 92 (1945), plaintiff passenger of a common carrier had been directed to a cafe for an evening rest stop and defendant's bus driver had subsequently turned out the bus lights resulting in plaintiff's fall when she returned to the

bus in the dark. This was a case of active negligence on the part of defendant's driver who was held.

Likewise in the case of *Watts v. Colonial Stage Lines*, 45 Ga. App. 96, 163 S.E. 523 (1932) (cited in appellee's brief page 20) liability for injuries to a passenger was predicated upon active negligence. The defendant's driver, in directing a passenger to a restroom, wrongfully sent him down an unlighted stairway leading to a cellar.

"The plaintiff had the right to assume that he was not being directed into a mantrap or pit-fall. . . ." (163 S.E. 523 at 524).

Horelick v. Pennsylvania R. Co., 13 N.J. 349, 99 A. 2d, 652 (1953), cited by appellee at page 20 of her brief, involved a passenger's fall on an icy platform at the Washington railroad station which was owned and controlled by the Washington Terminal Company and used as the exclusive means of ingress and egress to its trains by the Pennsylvania Railroad Company. The Court held that the duty of the railroad was to provide a safe means of exit and at page 655 this duty was held to be non-delegable.

Appellee relies on *Hotels El Rancho, Inc. v. Pray*, 64 Nev. 591, 187 P. 2d 568 (1947) (appellee's brief, p. 21). The factual situation in that case is so clearly distinguishable as to make the analogy an absurdity. In the *Pray* case defendant hotel had laid out a cross-county horse race course over the land of a third party and directly over what defendant's agents knew (and had witnessed) to be a recent target area for an aerial bombing and rocket demonstration by

the United States Navy. No one else used the property after the demonstration. The Supreme Court of Nevada stated that the condition of the race course in question constituted an extraordinary danger, artificially created, amounting to a pitfall or mantrap. Such is not the fact in the case at bar.

Appellee cites *Zerner v. Cohen*, 87 N.Y.S. 2d 342, 275 A.D. 702 (1949) for the proposition that it was negligence for a person to fail to notify another of a defective condition in a cellar stairway (appellee's brief, p. 23). The half page per curiam decision, although terse, states that the action was predicated on the alleged negligence of Hannah Cohen in "directing" decedent to the cellar door and broom closet under inadequate lighting conditions without warning defendant of the condition (trap) behind the door.

Collins v. Hazel Lumber Co., 54 Wash. 524, 103 Pac. 798 (1908) was a case in which the defendant had felled two trees which blocked a public highway. Defendant caused a detour to be constructed around this road block, which detour was located on the land of a third party. Defendant had not received permission of the landowner to construct the detour on his land.

Plaintiff's husband was killed when his wagon overturned when traveling on the detour. There was evidence that the detour had been improperly maintained by the defendant.

The Court correctly held that the defendant under the circumstances, owed a duty to plaintiff to provide a means of transportation around the road block

and that the defendant could not escape liability by claiming that the detour was on land owned by a third party.

Appellee cites this for the proposition that appellant cannot escape liability by reason of the fact that appellee's injury occurred on property belonging to a third person (appellee's brief, p. 24). The general proposition is correct, that is, a wrongdoer cannot escape liability for his wrongful acts merely because they are committed on the land of a third party and the cited case is a good illustration of this rule since the defendant in that case undertook certain responsibility, to-wit: the maintenance of the detour. There was active negligence with respect to the defendant's undertakings and he should have been held liable. The rule, however, is not applicable to the facts in the case at bar where appellant had no right to occupancy, possession or control of the Temple premises greater than any other member of the general public.

Appellee has not cited any authority which when applied to the facts in this case hold that appellant owed a duty to appellee other than to refrain from active negligence and to warn appellee of any man-traps or pitfalls known to appellant or its authorized agents or servants.

CONCLUSION.

Appellee failed to introduce sufficient, competent evidence to form a basis for a finding of liability against appellee. Appellee had the burden of proving

her case against appellant and failed to sustain this burden.

Appellee now seeks to justify the judgment on the verdict entered against appellee upon the basis of interferences not supported by the record and upon legal authority inapplicable to the factual situation here presented. Appellee has not cited any competent authority to sustain her position. To allow the judgment against appellant to stand would be tantamount to an unwarranted extension of liability into a new field.

Here there is presented a case that never should have been submitted to the jury and the fact that the jury may have decided against the appellant on the basis of erroneously admitted evidence should not preclude the Court from taking appropriate action to rectify and correct this injustice by reversing the judgment of the lower court.

Dated, Honolulu, T. H.,

October 14, 1958.

Respectfully submitted,

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*Attorney for Appellant, Tradewind
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Of Counsel:

SMITH, WILD, BEEBE & CADES,

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No. 16,033

United States Court of Appeals
For the Ninth Circuit

TRADEWIND TRANSPORTATION COMPANY,
LIMITED, (Formerly known as Allen
Tours of Hawaii, Ltd.),

Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

Appeal from the United States District Court
for the Territory of Hawaii.

APPELLEE'S PETITION FOR A REHEARING.

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FILED

MAY 12 1959

PAUL P. O'BRIEN, CLERK



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No. 16,033

IN THE

**United States Court of Appeals
For the Ninth Circuit**

TRADEWIND TRANSPORTATION COMPANY,
LIMITED, (Formerly known as Allen
Tours of Hawaii, Ltd.),

Appellant,

VS.

BERNICE (TERRY) TAYLOR,

Appellee.

**Appeal from the United States District Court
for the Territory of Hawaii.**

APPELLEE'S PETITION FOR A REHEARING.

*To the Honorable Chief Judge, and to the Honorable
Associate Judges of the United States Court of
Appeals for the Ninth Circuit:*

Appellee in the above entitled cause respectfully requests the Court to reconsider its decision entered herein on April 21, 1959 and to grant appellee a rehearing in the above entitled cause on the following grounds:

I.

THE COURT, IN HOLDING THE EVIDENCE INSUFFICIENT, ER-RONEOUSLY FOLLOWED THE FEDERAL RULE REQUIRING SUBSTANTIAL EVIDENCE, RATHER THAN THE MORE LIBERAL HAWAIIAN RULE APPLICABLE UNDER THIS, A DIVERSITY CASE.

The court at page 8 as a foundation for holding the evidence insufficient states: "to sustain a jury verdict in the Federal Courts there must be substantial evidence. . . ."

It is conceded that this is the law in the federal courts except in a diversity case under the rule of *Erie v. Tompkins*, 304 U.S. 64. Under the rule of the *Erie* case the sufficiency of the evidence must be tested by state law. The case at bar is a diversity case.

Allison v. Tea Company, 99 F. 2d 507 (4th Cir. 1938);

Baskin v. Montgomery-Ward & Company, 104 F. 2d 531 (4th Cir. 1939);

Waldron v. Aetna Casualty, 141 F. 2d 230 (3rd Cir. 1944);

Twin City Company v. Dreger, 199 F. 2d 197 (8th Cir. 1952);

Occidental Life Ins. Co. v. Thomas, 107 F. 2d 876 (9th Cir. 1939).

The rule in Hawaii on the quantum of evidence necessary to sustain a verdict was set out in *Robinson v. Honolulu R. T. & L. Co.*, 20 Haw. 426 at page 431:

"In some jurisdictions the trial courts are expressly authorized by statute to set aside verdicts and grant new trials 'for insufficient evidence'.

In those jurisdictions the trial judges have a broader discretion than the circuit judges in this Territory have. Our statute provides that the jury shall be the exclusive judges of the facts in all cases tried before them. R.L. Sec. 1798. In this jurisdiction it is settled that a mere scintilla of evidence is insufficient to support a verdict. *Smith v. Hamakua Mill Co.*, 14 Haw. 669; *Wo Sing Co. v. Kwong Chong Wai Co.*, 16 Haw. 17. *But it has often been held that this court would not set aside a verdict where there was some evidence, i.e., more than a scintilla of evidence, to support it."*

The statute referred to was in force at the time of the trial of this case and is presently *Section 212-14 Revised Laws of Hawaii 1955*. It provides that there shall be no reversal "for any finding depending on the credibility of witnesses or the weight of the evidence. . . ." See also *Makainai v. Lalakea*, 25 Haw. 470; *Louis v. Victor*, 27 Haw. 262; *Solomon v. Niulii Ltd.*, 32 Haw. 865.

It is apparent from an analysis of this court's opinion in the instant case that the court weighed the credibility of Pagay and considered the weight of all the evidence. At page 5 of the opinion the court comments on the fact that Pagay was not an unfriendly witness. The court then goes on to quote in the body of its opinion testimony of Pagay unfavorable to appellee and in footnotes quotes testimony favorable to appellee. The court has obviously weighed the favorable and unfavorable testimony and given greater weight to the cross-examination of

Pagay while the jury apparently gave greater weight to the direct. In this the court erred. The view of the evidence most favorable to the prevailing party must be accepted in considering whether the testimony of a witness or party will support a verdict. It is for the jury to determine what weight must be given to the direct and cross-examination and the testimony of a witness as a whole. *Clark v. Torrington*, 63 A. 657, 79 Conn. 42; *Mathis v. Tutweiler*, 295 F. 661; *Gardiner v. Courtright*, 130 N.W. 322, 165 Mich. 54.

In *Johnson v. Union Pacific*, 233 F. 2d 427, 249 F. 2d 674, 352 U.S. 957, this court was reversed for setting aside a verdict on the basis of a misinterpretation by it of Idaho law. In the instant case the court did not inquire what the law in Hawaii was and the question was not briefed for the court. It is apparent from an analysis of Hawaii Supreme Court opinions dealing with the sufficiency of the evidence that the Supreme Court of Hawaii would not have set aside the verdict in the case at bar. In *Holstein v. Benedict*, 22 Haw. 441 at page 445, the court said:

“Each case must turn upon its own circumstances, and we are not prepared to say that in every case where in the opinion of the appellate court, the evidence in support of a claim is very slight and unsatisfactory, it is to be regarded as an insufficient foundation for a verdict.”

II.

THE COURT ERRONEOUSLY, EVEN UNDER THE FEDERAL RULE, WEIGHED THE EVIDENCE AND THE CREDIBILITY OF WITNESSES, IN DETERMINING THE SUFFICIENCY OF THE EVIDENCE.

Even if this court should conclude, contrary to the authorities cited in I above, that the federal substantial evidence rule applies in the instant case, its prior holdings would not justify a reversal of the judgment herein.

The weight of evidence, including all factors of credibility which do not render testimony incredible as a matter of law, is beyond the scope of appellate review of jury verdicts. *Bryson v. U. S.*, 238 F. 2d 657 (C.A. Cal. 1956).

The weight and credibility of evidence are solely within the jury's province to determine and matters as to which the reviewing tribunal has no right to inquire. *Bridgman v. U. S.*, 183 F. 2d 750 (C.A. Cal. 1950).

Court of Appeals cannot weigh evidence. *Chin Bick Wah v. U. S.*, 245 F. 2d 274 (C.A. Cal. 1957).

Court of Appeals cannot disturb a jury's resolution of conflicts in evidence. *S. Birch & Sons v. Martin*, 244 F. 2d 556 (C.A. Alaska, 1957).

In *Stone v. Farnell*, 239 F. 2d 750 (C.A. Cal. 1956), this court held that it *must* view the testimony in the light most favorable to the prevailing plaintiff. See also *Sandez v. U. S.*, 239 F. 2d 239 (C.A. Cal. 1956).

III.

SINCE THE PURPOSE OF PAGAY'S TESTIMONY WITH REGARD TO PRIOR SLIPS WAS TO ESTABLISH NOTICE, THE COURT ERRED IN HOLDING THAT SUCH EVIDENCE WAS INSUFFICIENT TO SUSTAIN THE VERDICT.

Plaintiff in the instant case relied on the testimony of the expert witness Ebert to establish the dangerous condition of the premises involved. The testimony of the witness Pagay with regard to what he had observed prior to the Taylor accident *was offered to establish notice* rather than to establish a dangerous condition.

It is significant that the court reversed on the sole ground that "the evidence was insufficient to bring such knowledge (dangerous condition) to appellant (Tradewind)" p. 8 of opinion. The court in the preceding paragraph erroneously paraphrased the trial court's instruction on this point as follows: "In order for there to be a recovery against appellant, there must be proof . . . that Tradewind knew that the condition . . . constituted a dangerous condition. . . ." Actually, the instruction given by the trial court, (p. 4 of opinion), authorized a verdict for plaintiff if defendant (Tradewind) *or its authorized employee* (Pagay) had actual knowledge of the condition. Pagay's testimony establishes clearly that he had such knowledge prior to the accident and the court must accept his testimony as true under the cases cited above.

In this connection see two recent cases, *Laird v. Mather*, 331 p. 2d 617 (S. Ct. Cal. 1958) and *Evans v. Penn. Railroad*, 255 F. 2d 205 (3rd Cir. 1958).

In the *Laird* case the vice-president of the defendant company had been told someone had slipped on the stairway involved. There was no direct testimony of anyone who had observed the slip. The court held that where the purpose of the offered evidence is to show notice, the strict requirement of similarity of conditions is relaxed, and all that is required is that previous accidents have been such as to attract defendant's attention to the dangerous situation which resulted in the litigated accident. The court said at page 623:

“If believed, the testimony would support a finding that defendant was aware that the hand-rail presented a hazard to the users of the stairway. It was, therefore, relevant and admissible not to show that someone actually fell, but to show defendant's knowledge of the dangerous condition of the stairway.”

In the case at bar the evidence on the issue of notice was properly admitted and sufficient to sustain the verdict under the law of Hawaii. This court in finding the evidence insufficient apparently (1) applied the incorrect rule as to quantum of evidence and (2) erroneously concluded that the testimony of Pagay was offered to establish a dangerous condition rather than to show notice.

CONCLUSION.

For the reasons stated above, appellee requests the court to grant its petition for rehearing and reargument of the case with regard to the specific issues set forth in this petition.

Dated, Honolulu, Hawaii,
May 6, 1959.

Respectfully submitted,

KENNETH E. YOUNG,

DAVID N. INGMAN,

*Attorneys for Appellee
and Petitioner.*

CERTIFICATE OF COUNSEL.

We hereby certify that in our judgment the foregoing petition for a rehearing is well-founded and that it is not interposed for delay.

Dated, Honolulu, Hawaii,
May 6, 1959.

KENNETH E. YOUNG,
DAVID N. INGMAN,
*Attorneys for Appellee
and Petitioner.*



No. 16035 ✓

United States
Court of Appeals
for the Ninth Circuit

RALPH C. GRANQUIST, District Director of Internal Revenue for the District of Oregon,
Appellant,

vs.

MARGARET HACKLEMAN,
Appellee.

Transcript of Record

Appeal from the United States District Court for the
District of Oregon

FILED

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No. 16035

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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United States Courthouse,
Portland, Oregon,
For Appellant.

ALVIN J. GRAY,
ROBERT F. FOLEY,
RICHARD H. M. HICKOK,
1044 Bond Street, Bend, Oregon,
For Appellee.

In the United States District Court
for the District of Oregon

Civil 8817

MARGARET HACKLEMAN,

Plaintiff,

vs.

RALPH C. GRANQUIST, District Director of Internal Revenue for the District of Oregon,

Defendant.

COMPLAINT

Comes now the plaintiff and for cause of action alleges:

I.

That this Court has jurisdiction of this action pursuant to Section 6213, Title 26, U.S.C.A.

II.

That the Plaintiff is the duly appointed, qualified and acting Executrix of the Estate of Abe Hackleman, Deceased.

III.

That on or about June 6, 1956, the plaintiff filed with the defendant income tax returns for herself for the years 1953 and 1954 and for the Estate of Abe Hackleman for the years 1953 and 1954, and paid the taxes and interest due thereon.

IV.

That on or about the sixth day of June, 1956, the defendant assessed an addition to the tax of ap-

proximately two thousand dollars under Section 6651, Title 26, U.S.C.A. and demanded payment thereof within ten days. Subsequent thereto the defendant filed a notice of levy with the Clerk of Crook County, Oregon, which said levy constitutes a lien against the real property of the Estate of Abe Hackleman located in Crook County, Oregon.

V.

That the defendant did not issue a notice of deficiency prior to the assessment of the additions to the tax as required under Sections 6212 and 6213, Title 26, U.S.C.A.

VI.

That unless restrained by this Court the defendant will cause a distraint warrant to be issued and served, thereby causing irreparable damage to the plaintiff and to the Estate of Abel Hackleman, deceased.

Wherefore the plaintiff prays for a temporary restraining order and an order of this Court enjoining the defendant or any of his agents or employees from issuing and serving a distraint warrant against the plaintiff or the Estate of Abe Hackleman, deceased, based upon the assessment of addition to the tax of the plaintiff and the Estate of Abe Hackleman, deceased, for the years 1953 and 1954, and declaring the defendant's assessment of additions to taxes and the lien created thereby null and void.

/s/ RICHARD H. M. HICKOK,
Attorney for Plaintiff.

State of Oregon,
County of Multnomah—ss.

I, Richard H. M. Hickok, being duly sworn, say that I am the attorney for the plaintiff herein and that the allegations contained in the foregoing complaint are true as I verily believe.

/s/ RICHARD H. M. HICKOK.

Subscribed and sworn to before me this 17th day of September, 1956.

[Seal] /s/ ALICE SIECKE,
Notary Public for Oregon.

My commission expires: March 17, 1958.

[Title of District Court and Cause.]

AFFIDAVIT

I, Richard H. M. Hickok, being first duly sworn, depose and say:

I.

That the plaintiff is engaged in the administration of the assets of the Estate of Abe Hackleman, which consists of a cattle and grain ranch in Crook County, Oregon. That she is currently in the process of harvesting ripe hay and rounding up cattle prior to the onset of severe weather and that any delay of such process will cause irreparable damage to the

crop and to the cattle. The continuation of this operation requires the use of funds in the bank and her presence. All of the funds and the assets of the plaintiff are currently being used in the operation of the ranch. The plaintiff has no other funds or assets available to her for the continued operation of the ranch.

II.

The action of the defendant will deprive the plaintiff of her rights to an administrative hearing **before the Tax Court** of the United States.

/s/ RICHARD H. M. HICKOK,
Attorney for Plaintiff.

Subscribed and sworn to before me this 17th day of September, 1956.

[Seal] /s/ ALICE SIECKE,
Notary Public for Oregon.

My commission expires March 17, 1957.

[Endorsed]: Filed September 17, 1956.

[Title of District Court and Cause.]

ORDER

This matter came on ex parte on the 17th day of September, 1956, on the motion of the plaintiff for a temporary restraining order, the plaintiff appearing by Richard H. M. Hickok and the defendant

not appearing, and the Court having heard a statement by Counsel for the plaintiff,

Now, Therefore, based upon the verified complaint herein and the affidavit attached thereto, it is hereby

Ordered and Adjudged as follows:

1. The defendant herein and his agents or employees are hereby restrained from enforcing or executing the assessment of additions to the taxes of the plaintiff and the Estate of Abe Hackleman, deceased, issued on or about June 6, 1956, and covering the calendar years 1953 and 1954, and in particular from issuing or serving a distraint warrant based upon said additions to taxes.

2. The defendant is hereby ordered to appear in this Court at two o'clock p.m. on Monday, September 24, 1956, to show cause if any there be why this order should not be continued.

3. This Order shall not be effective until the plaintiff files with the Clerk of this Court a cost bond in the amount of One Hundred Dollars.

Dated this 17th day September, 1956.

/s/ WILLIAM G. EAST,
Judge.

[Endorsed]: Filed September 18, 1956.

[Title of District Court and Cause.]

AMENDED COMPLAINT

Comes now the plaintiff and for cause of action alleges:

I.

That this Court has jurisdiction of this action pursuant to Section 6213, Title 26, U.S.C.A., and Section 1346, Title 26, U.S.C.A.

II.

That the Plaintiff is the duly appointed, qualified and acting Executrix of the Estate of Abe Hackleman, Deceased.

III.

That on June 5, 1956, the plaintiff filed with the defendant income tax returns for herself for the years 1953 and 1954 and for the Estate of Abe Hackleman for the years 1953 and 1954, and paid the taxes and interest due thereon.

IV.

That on or about the 6th day of June, 1956, the defendant assessed against Abe and Margaret Hackleman for the year 1953 a deficiency in tax, due to a mathematical error, of \$180.34, together with interest in the amount of \$28.76, and an addition to the tax for late filing of a return as provided by Section 291, Title 26 U.S.C.A. (1939) in the amount of \$346.16.

V.

That on or about the sixth day of June, 1956, the defendant assessed against the Estate of Abe Hackleman for the year 1953 a deficiency in tax due to a mathematical error in the amount of \$120.35 together with interest in the amount of \$22.85, and an addition to the tax for late filing of a return as provided by Section 291, Title 26, U.S.C.A. (1939) in the amount of \$476.31.

VI.

That the said assessments for the year 1953 under Section 291, Title 26, U.S.C.A., were not jeopardy assessments and the defendant did not issue a notice of deficiency prior to the assessment of the addition to the tax as required under Section 272, Title 26, U.S.C.A. (1939).

VII.

That on or about the sixth day of June, 1956, the defendant assessed against Margaret Hackleman for the year 1954, an addition to the tax for the late filing of a return as provided by Section 6651, Title 26 U.S.C.A. (1954), in the amount of \$578.49.

VIII.

That on or about the sixth day of June, 1956, the defendant assessed against the Estate of Abe Hackleman for the year 1954, an addition to the tax for the late filing of a return as provided by Section 6651, Title 26, U.S.C.A. (1954), in the amount of \$663.90.

IX.

That the said assessments for the year 1954 under Section 6651, Title 26, U.S.C.A., were not jeopardy assessments and the defendant did not issue a notice of deficiency prior to the assessment of the addition to the tax as required under Section 6213, Title 26, U.S.C.A. (1954).

X.

That unless restrained by this Court the defendant will cause a distraint warrant to be issued and served, thereby causing irreparable damage to the plaintiff and to the Estate of Abe Hackleman, deceased.

Wherefore, the plaintiff prays for a temporary restraining order and an order of this Court enjoining the defendant or any of his agents or employees from issuing and serving a distraint warrant against the plaintiff or the Estate of Abe Hackleman, deceased, based upon the assessment of addition to the tax of the plaintiff and the Estate of Abe Hackleman, deceased, for the years 1953 and 1954, and declaring the defendant's assessment of additions to taxes and the lien created thereby null and void.

/s/ RICHARD H. M. HICKOK,
Attorney for Plaintiff.

Duly verified.

Service of copy acknowledged.

[Endorsed]: Filed October 15, 1956.

[Title of District Court and Cause.]

MOTION TO DISMISS

The District Director of Internal Revenue for the District of Oregon, by C. E. Luckey, United States Attorney for the District of Oregon, his attorney, moves to dismiss the action upon the grounds that this Court is without jurisdiction thereof because this action is one to enjoin the collection of Internal Revenue taxes, the maintenance of which is expressly prohibited by Section 7421(a) of the Internal Revenue Code of 1954.

/s/ C. E. LUCKEY,
United States Attorney.

Portland, Oregon, 10th day of December, 1956.

/s/ C. E. LUCKEY,
United States Attorney.

Affidavit of service by mail attached.

[Endorsed]: Filed December 17, 1956.

[Title of District Court and Cause.]

OPINION

East, Judge.

This matter is before the Court upon, first, an order herein requiring the Defendant to show cause, if any there be, why the temporary restraining order heretofore entered herein, pendente lite, en-

joining Defendant, as Director, from issuing and serving a distrain warrant against the Plaintiff or the Estate of one Abe Hackleman should not be continued, and, second, the Defendant's Motion to dismiss the above-entitled cause.

Plaintiff is the Executrix of the Estate of Abe Hackleman, deceased, and appears herein for herself and as such Executrix, and seeks a declaration that the hereinafter referred to assessment of addition to tax by the Defendant and the lien created thereby null and void.

It appears from the records and files herein, assumed for the purposes of the above matters to be true, that on June 5, 1956, the Plaintiff filed income tax returns for herself and the Estate of Abe Hackleman for the years 1953 and 1954.

On June 6, 1956, Defendant assessed an addition to the tax (approximately \$2,000.00) by virtue of Section 291 of the Internal Revenue Code of 1939,¹ and Section 6651 of the Internal Revenue Code of

¹ Sec. 291. Internal Revenue Code of 1939. "(a) In case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there should be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax

1954.² Defendant demanded payment thereof within ten days. Defendant subsequently filed a notice of levy with the Clerk of Crook County, Oregon, constituting a lien against the real property of the Estate of Abe Hackleman.

The question is whether a delinquency penalty is a "deficiency" within the meaning of Section 272 (a) (1) of the Internal Revenue Code of 1939,³

shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612(d) (1)."

² Sec. 6651 Internal Revenue Code of 1954. "(a) Addition to the tax. In case of failure to file any return required under authority of subchapter A of Chapter 61 * * * unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there shall be added to the amount required to be shown as tax on such return 5 per cent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 per cent for each additional month or fraction thereof during which such failure continues, not exceeding 25 per cent in the aggregate."

³ Sec. 272(a) (1) Internal Revenue Code of 1939. "If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed * * * the taxpayer may file a petition with the Board of Tax Appeals for

tained therein that the "amount so added shall be collected in the same manner as the tax." The Court said, in determining the legislative intent:

"It is inconceivable to us that Congress could have intended the section to expressly provide one method of collection for these penalties and then to stultify itself by describing them in such terms as to require reference to another section for a different method of collection."

While the language used in the 1939 code would strongly indicate that a penalty under section 291 would not be a "deficiency," when read in connection with the 1954 code, a doubt clearly arises as to the legislative intent. As pointed out in *Davis vs. Dudley*, 124 F. Supp. 426, (while holding a penalty under section 294(d) of the 1939 code to be a deficiency):

"Hence, in the absence of unequivocal language to the contrary, such as is contained in Section 291, we think this type of penalty should be construed as a deficiency in order that the judgment of the Commissioner may be tested by the Tax Court as a safeguard against erroneous assessments and compulsory payment pending final decision."

At this point the Court directs attention to its footnote number 5, which reads as follows:

"In this connection it is interesting to note that in the Internal Revenue Code of 1954, in two sections (6651 and 6653) where the imposi-

tion of penalties likewise depends upon the exercise of judgment, collection thereof is by way of deficiency procedure and not in the manner of collecting taxes; see 6659.” (See footnote 4)

Section 6651 of the 1954 Code, as pointed out earlier, is the counterpart of Section 291 of the 1939 Code. While it is thus clear that under the 1954 Code the penalties assessed under Section 6651 for additions to taxes are “deficiencies” there remains the question of whether there was a change in the law by virtue of the 1954 Code.

Plaintiff contends that the conflict in decisions was due to the “vague language” of the 1939 Code and hence the new wording in Section 6659 of the 1954 Code to clarify the legislative intent. Plaintiff contends there was no change in the law.

At page 4568, 1954 U. S. Code and Cong. and Adm. News, the following appears regarding Section 6659:

“This section provides that the addition to the tax, additional amounts, and penalties provided by chapter 68 shall be assessed; collected, and paid in the same manner as taxes, except where otherwise specifically provided in another section of this title. This conforms to the rules under existing law. (Emphasis ours) By virtue of this section, it is unnecessary in other parts of the title to specifically refer to these additions to the tax when providing rules as to collection, assessment, etc., of taxes. This sec-

tion also makes clear that the procedures for the assessment of deficiencies in income, estate and gift taxes (including 90-day letters and appeal to the Tax Court) also apply to additions to those taxes.”

It is defendant’s contention that the Erie Forge decision was part of existing law and that if the 1954 Code did not change existing law, then the rule of the Erie Forge case must also apply to the 1954 Code.

It would appear that the language in Section 6659 of the 1954 Code, in effect, construes and clarifies the language used in Section 291 of the 1939 Code and therefore should be accepted as a declaration by Congress of the spirit and meaning of the 1939 Code as well as the 1954 Code.

While not specifically binding upon the Defendant, it appears that in the following cases the propriety of penalties similar to the instant case was presented to the Tax Court by the issuance of a notice of deficiency as is requested by the taxpayer in this case:

Fides v. Collector of Internal Revenue, 1942,
47 B.T.A. No. 280, affirmed 137 Fed. 2d, 731

Ross v. Collector of Internal Revenue, 1941
case, 44 B.T.A. 1

Taylor Securities, Inc. v. Collector of Internal Revenue, 1939 case, 40 B.T.A. 695

Groves v. Collector of Internal Revenue, 1938
38 B.T.A. 727

Fidelity Bankers Trust Company v. Collector of Internal Revenue, 1928, 37 B.T.A. 142

Pioneer Automobile Service Company v. Collector of Internal Revenue, 1937, 36 B.T.A. 213

Blenheim Company, Liquidated, v. Collector of Internal Revenue, 1940, 42 B.T.A. 1248 (affirmed 125 Fed. 2d, 906).

thereby indicating an acknowledged distinction between the factual situation of like cases with the instant case, and the peculiar factual situation of Erie Forge Company.

Furthermore, this Court feels that the plaintiffs are entitled to an administrative determination as to whether or not their failure to file a timely tax return was "due to reasonable cause and not due to wilful neglect."

Therefore, the Court concludes that the temporary restraining order, pendente lite, aforesaid, should be continued and that the motion of the defendant to dismiss the above-entitled cause should be denied. The defendant is allowed thirty days within which to answer plaintiff's complaint on its merits or submit the cause on plaintiff's prayer for permanent relief as prayed for upon the record.

Counsel for plaintiff is requested to submit appropriate order in conformity with the foregoing.

Dated, January 7, 1957.

[Endorsed]: Filed January 7, 1957.

[Title of District Court and Cause.]

RESTRAINING ORDER

This matter having been heard upon motion of the plaintiff for a restraining order, the plaintiff appearing by Richard H. M. Hickok, and the defendant appearing by Edward J. Georgeff, Assistant United States Attorney, and the Court having heard statements by counsels for the plaintiff and defendant, and memoranda of law having been filed herein,

Now, Therefore, Based upon verified complaint herein and the affidavit attached thereto, the memoranda of law and arguments by counsels, it is hereby Ordered and Adjudged as follows:

1. The motion of the defendant to dismiss the complaint of the plaintiff is denied.

2. The defendant herein, his agents or employees, are hereby restrained from enforcing or executing the assessment of additions to the taxes of the plaintiff and the estate of Abe Hackleman, deceased, issued on or about June 6, 1956, and covering the calendar years 1953 and 1954, and particularly from issuing or serving a distraint warrant based upon said addition to said taxes, until further order herein.

3. The defendant is allowed thirty days within which to answer plaintiff's complaint on its merits or to submit the cause of plaintiff's prayer for permanent relief as prayed for upon the record.

Dated this 14th day of January, 1957.

/s/ WILLIAM G. EAST,
Judge.

[Endorsed]: Filed January 14, 1957.

[Title of District Court and Cause.]

ANSWER

Comes now Ralph C. Granquist, District Director of Internal Revenue for the District of Oregon, the defendant above named, by C. E. Luckey, United States Attorney for the District of Oregon, his attorney, and for his answer to the complaint herein, alleges as follows:

I.

Denies each and every allegation contained in paragraph I of the complaint.

II.

Admits each and every allegation contained in paragraph II of the complaint.

III.

Admits each and every allegation contained in paragraph III of the complaint.

IV.

Denies each and every allegation contained in paragraph IV of the complaint, except he admits that on or about the 6th day of June, 1956, there

was assessed against Abe and Margaret Hackleman additional income taxes for the year 1953 because of a mathematical error in their return for that year, in the sum of \$180.34, together with interest in the sum of \$28.76, and penalty for late filing of the return for that year in the sum of \$346.16.

V.

Denies each and every allegation contained in paragraph V of the complaint, except he admits that on or about the 6th day of June, 1956, there was assessed against the Estate of Abe Hackleman additional income taxes for the year 1953 because of a mathematical error in his return for that year, in the sum of \$120.35, together with interest in the sum of \$22.85, and penalty for late filing of the return in the sum of \$476.31.

VI.

Admits each and every allegation contained in paragraph VI of the complaint.

VII.

Admits each and every allegation contained in paragraph VII of the complaint.

VIII.

Admits each and every allegation contained in paragraph VIII of the complaint.

IX.

Admits each and every allegation contained in paragraph IX of the complaint.

X.

Denies each and every allegation contained in paragraph X of the complaint.

For a Complete Defense to the Cause of Action
Alleged In the Complaint:

XI.

That this Court is without jurisdiction of the subject matter of this suit because it is a suit to enjoin the collection of internal revenue taxes, the maintenance of which is expressly prohibited by Section 6421(a), Internal Revenue Code of 1954.

For a Further Complete Defense to the Cause of
Action Alleged In the Complaint:

XII.

That the complaint fails to state a claim against the defendant upon which relief can be granted.

Wherefore, defendant demands judgment dismissing the complaint.

/s/ C. E. LUCKEY,
United States Attorney;

/s/ EDWARD J. GEORGEFF,
Assistant United States
Attorney.

Affidavit of service by mail attached.

[Endorsed]: Filed April 12, 1957.

[Title of District Court and Cause.]

MOTION FOR SUMMARY JUDGMENT

Upon the verified complaint herein and upon the verified answer herein, the Plaintiff moves the Court as follows:

1. That judgment issue from this Court decreeing that the defendant's assessment against Margaret Hackleman and Abe Hackleman for the year 1953 of a deficiency in tax due to an addition to the tax for the late filing of a return under Sec. 291, Title 26, U.S.C.A. (1939) in the amount of \$346.16, and the defendant's assessment against the estate of Abe Hackleman for the year 1953 of a deficiency in tax due to an addition to the tax for the late filing of a return under Sec. 291, Title 26, U.S.C.A. (1939) in the amount of \$476.11, and the defendant's assessment against Margaret Hackleman for the year 1954 of a deficiency in tax due to an addition to the tax for the late filing of a return under Section 6651, Title 26, U.S.C.A. (1954) in the amount of \$578.41, and the defendant's assessment of a deficiency in tax against the Estate of Abe Hackleman for the year 1954 due to an addition to the tax for the late filing of a return under Section 6651, Title 26, U.S.C.A. (1954) in the amount of \$663.90, be declared void and without legal effect.

2. That a judgment issue from this Court, enjoining the defendant from assessing said additions to the tax without complying with the deficiency procedure provided for in Section 6213, Title 26, U.S.C.A. (1954).

As grounds for this Motion, the plaintiff will rely upon Rule 56, Federal Rules of Civil Procedure, applicable to motions for summary judgment where there remain no issues of fact.

/s/ RICHARD H. M. HICKOK,
Attorney for Plaintiff.

Affidavit of service by mail attached.

[Endorsed]: Filed October 18, 1957.

[Title of District Court and Cause.]

MOTION FOR SUMMARY JUDGMENT AND
OPPOSITION TO PLAINTIFF'S MOTION
FOR SUMMARY JUDGMENT

Comes now the defendant by his attorney, C. E. Luckey, United States Attorney for the District of Oregon, and Edward J. Georgeff, Assistant United States Attorney, and moves the Court to grant defendant's motion for summary judgment and deny plaintiff's motion for summary judgment for the following reasons:

(1) That the additions to taxes imposed under Section 291 of the Internal Revenue Code of 1939 and Section 6651 of the Internal Revenue Code of 1954, (failure to file timely federal income tax returns) against Abe and Margaret Hackleman, Estate of Abe Hackleman and Margaret Hackleman, where applicable, were properly assessed and did not require the sending of a notice of proposed deficiency (90-Day letter) preliminary to assessment.

provided for in Sec. 6213, Title 26, U.S.C.A., (1954).

Dated this 13th day of January, 1958.

/s/ WILLIAM G. EAST,
District Judge.

[Endorsed]: Filed January 13, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Margaret Hackleman, plaintiff, and Richard H.
M. Hickok, attorney for plaintiff:

Notice is hereby given that Ralph C. Granquist, District Director of Internal Revenue for the District of Oregon, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment entered in this action on the 13th day of January, 1958, in favor of plaintiff and against defendant.

Dated this 27th day of February, 1958, at Portland, Oregon.

C. E. LUCKEY,
United States Attorney
for the District of Oregon.

/s/ EDWARD J. GEORGEFF,
Assistant United States
Attorney.

[Endorsed]: Filed February 27, 1958.

[Title of District Court and Cause.]

ORDER

This matter coming on to be heard ex parte upon motion of defendant for an order extending time for the filing of the record on appeal and docketing the within action in the United States Court of Appeals for the Ninth Circuit to enable The Solicitor General to have additional time to consider said appeal, and the Court being fully advised in the premises.

It Is Ordered that the time for filing the record on appeal and docketing the within action be and it is hereby extended to ninety days from February 27, 1958, the date of filing of the Notice of Appeal.

Dated at Portland, Oregon this 7th day of April, 1958.

/s/ WILLIAM G. EAST,
Judge.

[Endorsed]: Filed April 7, 1958.

[Title of District Court and Cause.]

DOCKET ENTRIES

1956

Sept.17—Filed complaint

Sept.17—Issued summons — to marshal

Sept.17—Entered order specially admitting Richard
H. M. Hickok for this case

Sept.17—Entered order granting temporary restraining order & preliminary injunction

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& setting hearing on order to show cause why same should not be continued to Sept. 24, 1956 at 2 p.m.

Sept. 17—Entered order for bond of \$100

Sept. 18—Filed motion for temporary restraining order & preliminary injunction

Sept. 18—Filed undertaking on injunction

Sept. 18—Filed order for temporary restraining order & preliminary injunction & order to show cause

Sept. 21—Entered order setting order to show cause to Oct. 1, 1956 at 2 p.m.

Sept. 19—Filed summons with marshal's return

Oct. 1—Entered order specially admitting Mr. John J. Sexton for purposes of this case

Oct. 1—Entered order allowing 15 days within which to file amended complaint

Oct. 1—Record of hearing on order to show cause & under advisement

Oct. 15—Filed amended complaint

Oct. 15—Filed praecipe for summons

Oct. 16—Issued summons on amended complaint-to marshal

Oct. 23—Filed summons with marshal's return

Nov. 23—Filed & entered order granting deft. until & including Dec. 17, 1956, to answer or appear

Dec. 17—Filed motion of defendant to dismiss

Dec. 27—Filed plaintiff's memo in deft's motion to dismiss

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- Dec. 31—Record of hearing on deft. motion to dismiss and under advisement on record
- Jan. 7—Filed opinion
- Jan. 14—Filed & entered restraining order
- Feb. 6—Filed stipulation for order extending time to March 6, 1957
- Feb. 6—Filed & entered order extending time to March 6, 1957
- Mar. 4—Filed notice of appeal by defendant
- Mar. 6—Filed & entered order suspending proceedings as to def. until further order of ct.
- Apr. 12—Filed stipulation
- Apr. 12—Filed & entered order dismissing appeal
- Apr. 12—Filed answer
- Oct. 18—Filed motion of plaintiff for summary judgment
- Oct. 25—Filed motion of deft. for summary judgment, etc.
- Dec. 12—Filed stipulation re submission to court for decision without further argument, etc.

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- Jan. 13—Filed & entered judgment
- Feb. 28—Filed notice of appeal by defendant
- Apr. 7—Filed motion for extension of time to docket appeal
- Apr. 7—Filed & entered order extending time 90 days after Feb. 27, 1958, to docket appeal
- May 26—Filed designation of contents of record on appeal

In the United States District Court for the
District of Oregon

CERTIFICATE OF CLERK

United States of America
District of Oregon—ss:

I, R. DeMott, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of Complaint; Restraining order; Amended complaint; Defendant's motion to dismiss action; Opinion of Judge William G. East; Restraining order; Answer; Plaintiff's motion for summary judgment; Defendant's motion for summary judgment and opposition to plaintiff's motion for summary judgment; Judgment; Notice of appeal by defendant; Order extending time to docket appeal; Designation of contents of record on appeal and Transcript of docket entries constitute the record on appeal from a judgment of said court in a cause therein numbered Civil 8817, in which Ralph C. Granquist, District Director of Internal Revenue for the District of Oregon is the defendant and appellant and Margaret Hackleman is the plaintiff and appellee; that the said record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 27th day of May, 1958.

R. DEMOTT,
Clerk;

By /s/ THORA LUND,
Deputy.

[Endorsed]: No. 16035. United States Court of Appeals for the Ninth Circuit. Ralph C. Granquist, District Director of Internal Revenue for the District of Oregon, Appellant, vs. Margaret Hackleman, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed: May 29, 1958.

Docketed: May 29, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16035

RALPH C. GRANQUIST, District Director of Internal Revenue for the District of Oregon,
Appellant,

vs.

MARGARET HACKLEMAN,
Appellee,

STATEMENT OF POINTS UPON WHICH
THE APPELLANT WILL RELY

The District Court erred in concluding that the assessment of delinquency penalties under Section 291(a), Internal Revenue Code of 1939 and under Section 6651(a), Internal Revenue Code of 1954, is subject to the restrictions upon assessment provided by Section 272(a), Internal Revenue Code of 1939 and by Section 6313(a), Internal Revenue Code of 1954.

/s/ C. E. LUCKEY,

United States Attorney for
the District of Oregon.

Affidavit of Service by Mail attached.

[Endorsed]: Filed June 25, 1958.

In the United States Court of Appeals
for the Ninth Circuit

RALPH C. GRANQUIST, District Director of Internal
Revenue for the District of Oregon, APPELLANT

v.

MARGARET HACKLEMAN, APPELLEE

On Appeal From The Judgment Of The United States
District Court For The District Of Oregon

BRIEF FOR THE APPELLANT

ANDREW F. OEHMANN,
Acting Assistant Attorney General.

LEE A. JACKSON,
I. HENRY KUTZ,
FRED E. YOUNGMAN,
Attorneys,
Department of Justice,
Washington 25, D. C.

C. E. LUCKEY,
United States Attorney.

EDWARD J. GEORGEFF,
Assistant United States Attorney.

FILE
JUL 24 1938
PAUL F. O'BRIEN



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Delinquency penalties imposed under Sections 291(a) of the Internal Revenue Code of 1939 and 6651(a) of the Internal Revenue Code of 1954 for the late filing of income tax returns may be assessed and collected, as are the self- returned taxes reported upon such returns, without the prior issuance of ninety-day de- ficiency letters.....	9
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**In the United States Court of Appeals
for the Ninth Circuit**

No. 16035

**RALPH C. GRANQUIST, District Director of Internal
Revenue for the District of Oregon, APPELLANT**

v.

MARGARET HACKLEMAN, APPELLEE

**On Appeal From The Judgment Of The United States
District Court For The District Of Oregon**

BRIEF FOR THE APPELLANT

OPINION BELOW

The opinion of the District Court (R. 11-19), rendered on the Director's motion to dismiss, is reported at 147 F. Supp. 826. The District Court rendered no opinion in granting judgment.

JURISDICTION

This proceeding is based on a complaint and supporting affidavit (R. 3-6) filed in the District Court of Oregon on September 17, 1956, and an amended complaint (R. 8-10) filed on October 15, 1956; the

prayers of which were, in substance, that the District Court permanently enjoin the collection of amounts assessed against the appellee and the Estate of Abe Hackleman, deceased, of which she is executrix, as penalties for the late filing of income tax returns for the years 1953 and 1954, and declare such assessments null and void. Jurisdiction of the District Court apparently was sought to be invoked under Section 6213 of the Internal Revenue Code of 1954 (R. 3, 8) and 28 U.S.C., Section 1346 (referred to as "Section 1346, Title 26, U.S.C.A." (R. 8)). The District Director of Internal Revenue, appellant herein, moved to dismiss the action for lack of jurisdiction on the ground that it was an action to enjoin the collection of internal revenue taxes, the maintenance of which is expressly prohibited by Section 7421(a) of the Internal Revenue Code of 1954. (R. 11.) Under date of January 7, 1957, the District Court entered an opinion on the Director's motion to dismiss (R. 11-19), and on January 14, 1957, entered an order (R. 20-21) denying the motion to dismiss, restraining the collection of the penalties in issue until further order, and allowing the District Director 30 days within which to answer the complaint on the merits or submit to the prayer thereof. The District Director filed an answer to the complaint (R. 21-23) on April 12, 1957, again asserting lack of jurisdiction in the court below to grant the relief prayed for. Motions for summary judgment were filed by the appellee on October 18, 1957 (R. 24-25), and by the District Director on October 25, 1957 (R. 25-26). A judgment granting appellee the

relief prayed for was entered by the District Court on January 13, 1958 (R. 26-28), and notice of appeal was filed by the District Director on February 27, 1958 (R. 28). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether delinquency penalties, imposed under Sections 291(a) of the Internal Revenue Code of 1939 and 6651(a) of the Internal Revenue Code of 1954 for the late filing of income tax returns, may be assessed and collected, as are the self-returned taxes reported upon such returns, without the prior issuance of ninety-day deficiency letters.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Codes of 1939 and 1954 and Treasury Regulations are printed in the Appendix, *infra*.

STATEMENT

The facts are essentially not in dispute, as appears from the pleadings (amended complaint (R. 8-10); answer (R. 21-23)).

The appellee, Margaret Hackleman, is executrix of the Estate of Abe Hackleman, deceased.¹ On June 5, 1956, she filed with the appellant, District Director of Internal Revenue for the District of Oregon income tax returns for herself for 1953 and 1954 and for the Estate of Abe Hackleman for 1953 and 1954, and

¹ The date of death is not shown.

paid the taxes and interest due thereon. (R. 8, 21.)

On or about June 6, 1956, there was assessed against Abe and Margaret Hackleman, because of a mathematical error in their return for that year, additional income taxes for the year 1953 in the sum of \$180.34, together with interest in the sum of \$28.76, and a penalty for late filing of the return for that year in the sum of \$346.16; and on or about the same date there was assessed against the Estate of Abe Hackleman, because of a mathematical error in the return for that year, additional income taxes for the year 1953 ² in the sum of \$120.35, together with interest in the sum of \$22.85, and a penalty for late filing of the return in the sum of \$476.31. These assessments for 1953 were not jeopardy assessments, and statutory notices of deficiency required by Section 272(a) of the Internal Revenue Code of 1939 were not issued prior to the making of the assessments.³ (R. 8, 9, 22.)

Also, on or about June 6, 1956, there was assessed against Margaret Hackleman for the year 1954 an addition to the tax for that year in the sum of \$578.49, as provided by Section 6651 of the Internal Revenue Code of 1954, for the late filing of her return for that year; and on or about the same date there was assessed against the Estate of Abe Hackleman for the year 1954 an addition to the tax for that

² The allegations of paragraphs IV and V of the complaint (R. 8, 9) indicate that Abe Hackleman died in 1953 and that the appellee filed a joint return for herself and him for that year and also a return for the estate.

³ The additional income taxes and interest assessed for 1953 due to mathematical errors in the returns are not in issue in this proceeding—only the penalties for late filing.

year in the sum of \$663.90, as provided by Section 6651 of the 1954 Code, for the late filing of the return for that year. These assessments for 1954 were not jeopardy assessments, and statutory notices of deficiency required by Section 6212⁴ of the 1954 Code were not issued prior to the making of the assessments. (R. 9, 10, 22.)

The present action is to enjoin collection of the above amounts assessed as penalties for late filing of returns, and to invalidate the assessments for these penalties, on the ground that statutory deficiency notices were not issued prior to the making of the assessments. The District Court entered summary judgment granting the relief prayed for (R. 26-28), and the Director appealed (R. 28).

STATEMENT OF POINT TO BE URGED

The District Court erred in concluding that the assessment of delinquency penalties under Section 291(a) of the Internal Revenue Code of 1939 and under Section 6651(a) of the Internal Revenue Code of 1954 is subject to the restrictions upon assessment of deficiencies in income tax provided by Section 272(a) of the Internal Revenue Code of 1939 and Section 6213 of the Internal Revenue Code of 1954. (R. 34.)

SUMMARY OF ARGUMENT

This is an action to enjoin the collection of delinquency penalties assessed in connection with the late

⁴ Erroneously alleged as Section 6213 in the complaint. (R. 10.)

filing of federal income tax returns for the years 1953 and 1954. An action to restrain the assessment and collection of federal taxes will lie only in the case of exceptional and unusual circumstances or where specifically by authorized statute, and the same rule is applicable to civil penalties assessed in connection with such taxes. The instant case presents no exceptional and unusual circumstances upon which equity jurisdiction may be founded, and this action will lie only if the penalties in issue are "deficiencies" within the meaning of applicable provisions of the Internal Revenue Codes of 1939 and 1954.

The Board of Tax Appeals, now the Tax Court, was created as a forum where taxpayers may litigate their liability for deficiencies in federal income, estate, and gift taxes before being required to pay them, and the term "deficiency" has been defined in the various internal revenue statutes dealing with the subject to delimit the jurisdiction of the Tax Court in such matters. The term has reference to *taxes* imposed by the various statutes. In essence, a "deficiency", as variously defined by the statutes, is the excess of the amount determined by the Commissioner to be the correct amount of *tax* due by the taxpayer over the amount reported by him on his return; and if no return is filed, or no amount is reported on the return as tax due, then the amount determined by the Commissioner to be the correct amount of *tax* due is a "deficiency". If a "deficiency" in *tax* is determined by the Commissioner the Tax Court may have jurisdiction, upon a timely appeal to it, to adjudicate all issues, including penalties, relating to the taxpayer's

liability for the year for which the "deficiency" in *tax* is determined by the Commissioner. But delinquency penalties are not "deficiencies" within the meaning of the applicable statutes.

The District Court has confused "deficiencies" in *tax* with civil sanctions which are imposed under the several statutes as *additions to the tax*, and which are to be assessed, collected, and paid at the same time, as a part of, and subject to the same conditions and limitations as the tax with respect to which they are imposed. The delinquency penalties involved in this case for 1953 were assessed under Section 291(a) of the 1939 Code, which provides that such penalties "shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax." The taxes on which these penalties were computed were the original taxes shown on the delinquent returns. They were not "deficiencies" in tax within the meaning of the statute, and, like the original tax, were collectible by distraint or proceeding in court without the necessity of prior notice of deficiency. The taxes having been paid, moreover, the penalties were collectible "in the same manner as the tax", i.e., by distraint or proceeding in court without the necessity of a prior notice. Accordingly, the limitation imposed by Section 272(a) of the 1939 Code upon the assessment and collection of "deficiencies" in tax is inapplicable here.

The delinquency penalties here involved for 1954 were assessed under Section 6651 of the 1954 Code,

which, unlike Section 291(a) of the 1939 Code relating only to delinquent income tax returns, imposes civil sanctions for delinquencies with respect to a number of taxes, previously imposed under several sections of the 1939 Code. Provisions relating to the assessment and collection of *all* such sanctions imposed under Section 6651 are set out in Section 6659 of the 1954 Code. No distinction is made with respect to civil penalties imposed in connection with income, estate, and gift taxes over which the Tax Court is given jurisdiction. Without distinction, Section 6659 (a) declares that such additions to the tax "shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes". Subsection (b) of Section 6659 of the 1954 Code comprehends, not merely many types of taxes, but also penalties which are to be collected in the course of a deficiency proceeding (see Section 6653) as well as penalties to be collected by assessment without prior deficiency notice (as self-returned taxes are collected). Thus, since Section 6659(b) comprehends both types of proceeding, it includes a parenthetical reference to the deficiency procedure; clearly, however, no direction that this procedure is to be applied under all situations, such as the record state of facts, was intended.

The language employed in Section 6659 of the 1954 Code necessarily differs from the language of Section 291(a) of the 1939 Code because it was framed to include all sanctions imposed under Chapter 68, while Section 291(a) was limited to delinquent income tax returns, but the provisions did not effect any change

in existing law. The delinquency penalties here involved for 1954 having been assessed in connection with the original tax reported on the taxpayers' returns for that year, and no "deficiency" in tax having been determined, the amount in issue "shall be considered a part of such [original] tax for the purpose of applying the provisions" of the 1954 Code "relating to the assessment and collection of such tax". (Section 6659(b).) Since no deficiency in tax was determined, the parenthetical portion of Section 6659 (b) is inapplicable, and assessment and collection of the delinquency penalties in issue for the latter year are not subject to the limitations of Section 6613 of the 1954 Code upon assessment and collection of "deficiencies" in tax.

The decision of the District Court is wrong. Its judgment should be vacated and judgment of dismissal should be directed in favor of the Director.

ARGUMENT

Delinquency Penalties Imposed Under Sections 291(a) Of The Internal Revenue Code Of 1939 And 6651(a) Of The Internal Revenue Code Of 1954 For The Late Filing Of Income Tax Returns May Be Assessed And Collected, As Are The Self-Returned Taxes Reported Upon Such Returns, Without The Prior Issuance Of Ninety-Day Deficiency Letters.

This action was brought to enjoin the collection of amounts assessed under Section 291(a) of the Internal Revenue Code of 1939 and Section 6651(a) of the Internal Revenue Code of 1954 (Appendix, *infra*) as penalties for the late filing of federal income tax returns for the years 1953 and 1954, and to have

such assessments declared void, and the District Court clearly erred as a matter of law in granting the relief prayed for.

Elemental in our system of federal jurisprudence is the principle that equitable relief may not be granted where the plaintiff has a plain, adequate and complete remedy at law, and the injunction herein was improvidently granted for that reason alone, because in this case the plaintiff clearly has a plain, adequate and complete remedy at law by payment of the penalties in issue and suing for a refund,⁵ and no allegations or showing to the contrary was made by the plaintiff.

Moreover, Sections 3653(a) of the 1939 Code and 7421(a) of the 1954 Code (Appendix, *infra*) specifically provide that "Except as provided in sections * * *, no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court", the excepting sections relied upon here by the District Court being Section 272(a) of the 1939 Code and Section 6213(a) of the 1954 Code (Appendix, *infra*). We submit the instant case does not fall within these statutory exceptions.

The above Sections 3653(a) and 7421(a) were derived from Section 3224 of the Revised Statutes, which latter section was in the nature of a revision of Section 10 of the Act of March 2, 1867, c. 169, 14 Stat. 471, 475, and by its terms admitted of no ex-

⁵ See Sections 322 and 3772 of the Internal Revenue Code of 1939; Sections 6511, 6532, and 7422 of the Internal Revenue Code of 1954.

ception to the prohibition against maintaining a suit to restrain assessment or collection of any federal tax. See *Snyder v. Marks*, 109 U.S. 189; *Pacific Whaling Co. v. United States*, 187 U.S. 447; *Dodge v. Osborn*, 240 U.S. 118; *Bailey v. George*, 259 U.S. 16; *Graham v. du Pont*, 262 U.S. 234. Despite this unqualified prohibition of the earlier statutes, the courts have recognized that equitable relief occasionally may be justified in exceptional and unusual circumstances (*Miller v. Nut Margarine Co.*, 284 U.S. 498), but the fortuitous circumstances that the amount in issue is a civil sanction or penalty, designated an addition to tax by the statute, as here, does not exclude the amount from the strict prohibition of Section 3224 of the Revised Statutes and corresponding provisions of the various later revenue statutes. However, the District Court did not base its determination herein on the ground of exceptional and unusual circumstances, and cases in which injunctive relief was granted on that ground are not helpful at this point.

Instead, the District Court based its judgment herein on an erroneous application of the statutory exception found in the above Sections 272(a) of the 1939 Code and 6213(a) of the 1954 Code to the maintenance of such suits. In its opinion (R. 11-19) filed in connection with the District Director's motion to dismiss for want of jurisdiction (R. 11), the District Court stated (R. 13-15) that the issue involved is whether a delinquency penalty (imposed under Section 291(a) of the 1939 Code and Section 6651(a) of the 1954 Code) is a "deficiency" within the meaning of Section 272(a) of the 1939 Code and/or Sec-

tion 6659⁶ of the 1954 Code; that if such penalties are deficiencies the 90-day letter is required and the injunction prayed for should be granted; and that if the delinquency penalties are not deficiencies there need be no 90-day letter and the injunction prayed for will not lie.

Examination of Section 271(a) of the 1939 Code and Section 6211(a) of the 1954 Code (Appendix, *infra*), defining the term "deficiency" for purposes of Sections 272 of the 1939 Code and Sections 6212 and 6213 of the 1954 Code, clearly indicates that such delinquency penalties, assessed under the circumstances of this case, could not possibly constitute a "deficiency" as therein defined.⁷ According to Sections 271(a) and 6211(a), the term "deficiency" as used in the respective statutes, "means" the amount by which the *tax* imposed by the statute⁸ exceeds the excess of the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the

⁶ The 1954 Code cognate of 1939 Code Section 272(a) is Section 6213(a). However, as discussed below, the District Court apparently considered Section 6659(b) of the 1954 Code to incorporate the terms of Section 6213(a) by reference.

⁷ By using the word "means" Congress intended an exclusive definition of the term "deficiency". See *Groman v. Commissioner*, 302 U.S. 82, 86.

⁸ The definition is the same in both Codes, except that Section 271 (a) of the 1939 Code applies only to income taxes, the term for estate and gift tax purposes being defined in Sections 870 and 1101, while the definition in Section 6211 of the 1954 Code applies to all three.

amounts previously assessed (or collected without assessment) as a deficiency, over the amount of rebates, as defined in subsection (b) (2) of the respective sections, made by the Commissioner.

The amounts here involved are not *tax* imposed by the respective statutes as that term is used in the above definition. They are amounts imposed by separate provisions of the respective statutes as a civil sanction or penalty for the late filing of an income tax return, and are described in the respective statutes as an addition to the tax. Section 291(a) of the 1939 Code and Section 6651(a) of the 1954 Code. But they are no more tax, at least for purposes of this case, than is the interest imposed by statute for late payment of the tax. Compare *Standard Oil Co. v. McMahon*, 244 F. 2d 11, 13 (C.A. 2d), and cases cited.

The term "deficiency" as used in the above sections of the 1939 and 1954 Codes was first written into the Revenue Act of 1924, c. 234, 43 Stat. 253, as Section 273, in conjunction with other related provisions of that Act (Section 900, amended by Section 1000 of the Revenue Act of 1926, c. 27, 44 Stat. 9) creating the Board of Tax Appeals, now the Tax Court, the purpose of which was to provide a ready forum where taxpayers could litigate any *additional* income tax liability claimed by the Commissioner before being required to pay it,⁹ and the obvious purpose of defin-

⁹ *Old Colony Tr. Co. v. Commissioner*, 279 U.S. 716, 719; *Ventura Consolidated Oil Fields v. Rogan*, 86 F. 2d 149 (C.A. 9th), certiorari denied, 300 U.S. 672; *Standard Oil Co. v. McMahon*, 244 F. 2d 11 (C.A. 2d); *United States v. Curd*

ing the term "deficiency" was to delimit the jurisdiction of the Tax Court.

The existence of a "deficiency" within the meaning of these statutes is essential to the Tax Court's jurisdiction to review a determination of liability by the Commissioner, and the meaning of the term as used in the statutes has been considered in a number of cases. See *Standard Oil Co. v. McMahon*, 244 F. 2d 11 (C.A. 2d); *Denton v. United States*, 235 F. 2d 733 (C.A. 3d), affirming 132 F. Supp. 741 (N.J.); *Bendheim v. Commissioner*, 214 F. 2d 26 (C.A. 2d); *McConkey v. Commissioner*, 199 F. 2d 892 (C.A. 4th), certiorari denied, 345 U.S. 924; *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970; *Fairbanks' Estate v. Commissioner*, 128 F. 2d 537 (C.A. 5th); *Superheater Co. v. Commissioner*, 125 F. 2d 514 (C.A. 2d); *Tyson v. Commissioner*, 66 F. 2d 160 (C.A. 7th), certiorari denied, 292 U.S. 657; *Uncasville Mfg. Co. v. Commissioner*, 55 F. 2d 893 (C.A. 2d), certiorari denied, 286 U.S. 545; *Jackson Iron & Steel Co. v. Commissioner*, 54 F. 2d 861 (C.A. 6th), certiorari denied, 286 U.S. 549; *Veeder v. Commissioner*, 36 F. 2d 342 (C.A. 7th); *Anderson v. Commissioner*, 11 T.C. 841; *Will County Title Co. v.*

(C.A. 5th), decided June 30, 1958 (2 A.F.T.R. 2d 5111); *Flora v. United States*, 357 U.S. 63. See H. Rep. No. 179, 68th Cong., 1st Sess., p. 62 (1924) (1939-1 Cum. Bull. (Part 2) 241, 258); S. Rep. No. 398, 68th Cong., 1st Sess., p. 30 (1924) (1939-1 Cum. Bull. (Part 2) 266, 287); H. Rep. No. 1, 69th Cong., 1st Sess., p. 10 (1925) (1939-1 Cum. Bull. (Part 2) 315, 321-322); S. Rep. No. 52, 69th Cong., 1st Sess., pp. 25-28 (1926) (1939-1 Cum. Bull. (Part 2) 332, 351-353).

Commissioner, 38 B.T.A. 1396; 9 Mertens, Law of Federal Income Taxation, Sections 49.10-49.13.

Whether the penalty assessments here involved constitute "deficiencies" within the meaning of the statute, notwithstanding the obvious fact that they are not deficiencies in *tax*, can best be tested in the light of the Tax Court's jurisdiction to review deficiency determinations of the Commissioner. Had the Commissioner determined deficiencies in tax for the years involved, and added delinquency penalties provided by the statutes, the Tax Court obviously would have had jurisdiction to review the Commissioner's determination, both as to the tax and as to the penalty, if a timely petition had been filed with it based upon a statutory notice of such determination. This was the situation in the several cases cited in the opinion of the District Court (R. 18-19),¹⁰ the determination of penalties in those cases being incidental to the determination of deficiencies in tax, which called for issuance of statutory notices of deficiency. The penalties were appropriately included in the deficiency notices, and were properly before the Tax Court for adjudication because the Tax Court

¹⁰ It is not clear whether the court was associating the factual situation in this case with the factual situation in the cited cases or with the "peculiar factual situation" of *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970. However, there was no deficiency in tax in the instant case, which could liken it to the cases cited. On the contrary, as in the *Erie Forge Co.* case, the penalties were based on the tax reported on the delinquent returns, which tax had been paid prior to assessment of the delinquency penalties.

had acquired jurisdiction by reason of the Commissioner's determination of deficiencies in *tax* in those cases. Many other cases of this character could be cited, but they are not determinative of the issue involved in the present proceeding because in none of them did the Tax Court's jurisdiction rest upon the Commissioner's assertion of delinquency penalties as a "deficiency" within the meaning of the statute.

On the other hand, there was no deficiency in *tax* in the instant case.¹¹ Moreover, the amounts shown as original tax on the delinquent returns had already been paid before the delinquency penalties were assessed. Apparently the Commissioner has never sought by issuance of statutory deficiency notice to collect penalties due under such circumstances. In any event, there is nothing in any of the authorities cited above and we have found none, even remotely suggesting that the Tax Court would have jurisdiction in this case, even if a statutory deficiency notice were issued to the taxpayer. Rather, the contrary seems quite clear.

Since the delinquency penalties here in issue are not "deficiencies" within the meaning of the above statutory definition,¹² the judgment of the District

¹¹ The additional amounts collected for 1953 on account of mathematical errors in the returns did not constitute deficiencies in tax within the meaning of the statutory definition and are not in dispute.

¹² *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970; *Standard Oil Co. v. MaMahon*, 244 F. 2d 11 (C.A. 2d).

Court herein can be justified only if the statutory provisions relating to the *collection* of such delinquency penalties require the Commissioner, under the circumstances of this case, to first issue a deficiency notice, and whether those provisions also give the Tax Court jurisdiction to review the Commissioner's action in assessing them before such penalties can be collected. The provisions applicable here are Section 291(a) of the 1939 Code, applicable to the year 1953, and Section 6659 of the 1954 Code, applicable to the year 1954. As to the year 1953, Section 291(a) provides that the delinquency penalty imposed by that section—

* * * shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. * * *

This language is clear. If the delinquency penalty imposed under that section is added to a "deficiency" in tax, it is to be collected "at the same time and in the same manner and as a part of" the deficiency, as in the cases cited by the District Court (R. 18-19), again, if the deficiency in tax is paid before the neglect is discovered, then the delinquency penalty would be collected "in the same manner as" the tax upon which it is based, that is, by deficiency procedure. Compare *McLaughlin v. Commissioner*, 29 B.T.A. 247 and *Middleton v. Commissioner*, 200 F. 2d 94 (C. A. 5th), dealing with fraud penalties imposed under another section of the 1939 Code, which are to be collected "in the same manner" as the deficiencies on which they are based. On the other hand,

where there is no deficiency and the delinquency penalty is added to the original tax reported on the return, as in the instant case, then whether or not the delinquent tax has already been paid, the penalty "shall be collected in the same manner as the tax." Since the tax shown on the return can only be collected by distraint or by a proceeding in court (and not by issuance of what purported to be a deficiency notice because the Tax Court would not have jurisdiction),¹³ the delinquency penalty can only be collected in the same manner. *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970. Compare *Standard Oil Co. v. McMahon*, 244 F. 2d 11 (C.A. 2d); *United States v. Curd* (C.A. 5th), decided June 30, 1958 (2 A.F.T.R. 2d 5111). Accordingly, not only was a deficiency notice not required in the instant case, but it would have been a useless gesture on the part of the Commissioner, for it could not give the Tax Court jurisdiction and the District Court clearly erred in enjoining collection on the ground that deficiency notices had not been issued.

In its opinion on the Director's motion to dismiss, the District Court admitted that the above language of the 1939 Code "would strongly indicate that a penalty under section 291 would not be a 'deficiency' ", but by a process of reasoning which we submit was unsound the court concluded, "when read in connection with the 1954 Code, a doubt clearly arises as to the legislative intent" with respect to the 1939 Code.

¹³ Compare *McConkey v. Commissioner*, 199 F. 2d 892 (C. A. 4th), certiorari denied, 345 U. S. 924.

(R. 16.) Earlier in its opinion, after quoting the above language of the 1939 Code, the District Court stated (R. 15): "However, in the 1954 Code this language was carried over in Section 6659 (see footnote 4) *but with the additional language that clearly states that any addition to tax under Section 6651 shall be considered a deficiency*". (Italics supplied.) We are not told specifically what "additional language" in Section 6659 (applicable in the instant case for the year 1954), the court had in mind, but surely the language of that section does not warrant the construction that "any addition to tax" under Section 6651 "shall be considered a deficiency". Moreover, there is nothing in that section or its legislative history which could give rise to any doubt as to the legislative intent in enacting Section 291(a) of the 1939 Code—or, for that matter, any doubt as to the legislative intent in enacting Section 6659 of the 1954 Code.

The language of Section 6659 differs from the language of Section 291, but the 1954 Code did not effect any change in law so far as the instant case is concerned. The change in language resulted from changes in codification of the internal revenue laws. Application of Section 291 of the 1939 Code was limited to cases of failure to file a timely return "required by this chapter", being Chapter 1, dealing with income taxes,¹⁴ while Sections 6651 and 6659 of the

¹⁴ Section 291 was made applicable to the additional income tax imposed under Chapter 2 of the 1939 Code by Section 508, while the delinquency penalty imposed by Section 3612(d) (1) of the 1939 Code were made applicable to estate and gift taxes by Sections 894 and 1018 of the 1939 Code.

1954 Code are a codification of many of the penalty provisions found in the 1939 Code.¹⁵ Section 6659, entitled "Applicable Rules", is the concluding section of Subchapter A, Chapter 68, of the 1954 Code. Chapter 68 is entitled "Additions to the Tax, Additional Amounts, and Assessable Penalties". Subchapter A (Sections 6651-6659) deals with additions to the tax and additional amounts, while Subchapter B (Sections 6671-6675) deals with assessable penalties.

The first section of Subchapter A (Section 6651), under which the delinquency penalties for 1954 were assessed in this case, imposes such penalties for failure to file timely returns, declarations, statements, etc., including income tax returns as required by Subchapter A of Chapter 61 (other than part III thereof, dealing with information concerning persons subject to special provisions, transactions with other persons, and information regarding wages paid to employees); for failure to file timely returns as required by Subchapter A of Chapter 51 relating to distilled spirits, wines and beer; for failure to file timely returns as required by Subchapter A of Chapter 52, relating to tobacco, cigars, cigarettes, and cigarette papers and tubes; and for failure to file timely returns as required by Subchapter A of Chapter 53, relating to machine guns and certain other firearms. Other sections of Subchapter A, Chapter 68, including Section 6653 imposing civil negligence and fraud penalties with respect to underpayments of tax, are not directly

¹⁵ For instance, Sections 51(g) (6), 291, 293, 871(i), 1019, 1117(g), 1634(b), 1718(c), 1821(a) (3), 3310(a) through (e), 3311, 3655(a) and (b) of the 1939 Code.

relevant here, but with respect to all of the enumerated sanctions subsection (a) of Section 6659 provides:

(a) *Additions Treated as Tax*.—Except as otherwise provided in this title—

(1) The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

(2) Any reference in this title to "tax" imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

As pointed out above, in Subchapter A of Chapter 68 Congress has collected provisions scattered throughout the 1939 Code imposing civil sanctions for delinquency, negligence and fraud,¹⁶ in addition to the provisions imposing sanctions for delinquency, negligence, and fraud in the filing of income, estate and gift tax returns over which the Tax Court is given jurisdiction in case of a deficiency determination by the Commissioner. But no distinction is made in the above quoted subsection with respect to the latter, the subsection merely providing that all of the enumerated civil sanctions "shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes". This subsection did not purport to effect any change in existing law, and there is nothing in the subsection to support the

¹⁶ See fn. 15, *supra*.

statement of the District Court (R. 15) that the “additional language” in Section 6659 “clearly states that any addition to tax under Section 6651 shall be considered a deficiency”.

While we are not advised what “additional language” the District Court had in mind, the reference probably was to subsection (b) of Section 6659, which provides that—

Any addition under section 6651 or section 6653 to a tax imposed by another subtitle of this title *shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax* (including the provisions of subchapter B of chapter 63, relating to deficiency procedures for income, estate, and gift taxes). [Italics supplied.]

This subsection was cast in broader language than Section 291(a) of the 1939 Code to cover additions to taxes other than additions for the late filing of income tax returns, and like subsection (a) it makes no distinction with respect to the various categories of taxes to which sanctions may be added, the provision that any addition to tax under those sections “shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax” applying alike to all of the enumerated categories to tax. Neither the language just quoted nor the further parenthetical provision that any addition shall be considered as a part of the tax for the purpose of applying the assessment and collection provisions of the statute “(including the provisions of subchapter B

of chapter 63, relating to deficiency procedures for income, estate, and gift taxes)" is susceptible of the interpretation placed upon Section 6659 by the District Court. There is nothing in this subsection stating that "any addition to tax under Section 6651 shall be considered a deficiency". (R. 15.)

Moreover, instead of casting doubt on the legislative intent as reflected in Section 291(a) of the 1939 Code, Section 6659 of the 1954 Code accomplishes the same purpose in language which emphasizes the fact that the delinquency penalty is on the same footing as the tax with respect to which it is imposed so far as assessment and collection procedures are concerned. If the penalty is assessed in connection with a tax other than an income, estate, or gift tax it is subject to assessment and collection procedures applicable to such taxes. If the penalty is assessed in connection with an original income, estate, or gift tax reported on the return, as in the instant case, and no deficiency in tax is involved, it is subject to the assessment and collection procedures applicable to such original tax. Only when the penalty is asserted in connection with a deficiency in tax (limited to income, estate, and gift taxes) are the deficiency procedures for assessment and collection applicable to the penalty, and it is only in such situations that the limitations upon assessment and collection provided in Sections 272(a) of the 1939 Code and 6213(a) of the 1954 Code may be invoked. In neither situation would the fact that the tax (or deficiency) had been paid before the penalty was asserted alter the Commissioner's remedy for collecting the penalty. *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied,

343 U.S. 930, rehearing denied 343 U.S. 970; *Middleton v. Commissioner*, 200 F. 2d 94 (C.A. 5th). Compare *Standard Oil Co. v. McMahon*, 244 F. 2d 11 (C.A. 2d).

That Congress intended no change in existing law when it adopted Section 6659 of the 1954 Code is made clear in the Committee reports accompanying the legislation. The reports of both the Committee on Ways and Means of the House¹⁷ and the Committee on Finance of the Senate¹⁸ contain the following explanation of Section 6659:¹⁹

This section provides that the additions to the tax, additional amounts, and penalties provided by chapter 68 shall be assessed, collected, and paid in the same manner as taxes, *except where otherwise specifically provided in another section of this title. This conforms to the rules under existing law.* By virtue of this section, it is unnecessary in other parts of the title to specifically refer to these additions to the tax when providing rules as to collection, assessment, etc., of taxes. This section also makes clear that the procedures for the assessment of deficiencies in

¹⁷ H. Rep. No. 1337, 83d Cong., 2d Sess., p. A420 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4568).

¹⁸ S. Rep. No. 1622, 83d Cong., 2d Sess., p. 595 (3 U.S.C. Cong. & Adm. News (1954) 4621, 5245).

¹⁹ After erroneously holding that the penalties here involved for 1954 were "deficiencies" within the meaning of the 1954 Code, the District Court pointed to the Committee statements that Section 6659 did not effect any change in existing law and held that therefore the 1953 penalties were "deficiencies" under the 1939 Code. (R. 17-19.)

income, estate, and gift taxes (including 90-day letters and appeal to the Tax Court) also apply to additions to those taxes. (*Italics supplied.*)

Moreover, the foregoing interpretation is in accordance with the Treasury Regulations under Section 6659 of the 1954 Code. See Section 301.6659-1, adopted November 16, 1957 (Appendix, *infra*), which was not available to the court below when it rendered its opinion.

Furthermore, the District Court stated (R. 19)—

* * * this Court feels that the plaintiffs are entitled to an administrative determination as to whether or not their failure to file a timely tax return was "due to reasonable cause and not due to wilful neglect."

While the Commissioner had afforded taxpayer such administrative determination, the District Court undoubtedly was making reference to review by the Tax Court, defined by the Code as an independent agency in the Executive Branch of the Government (Section 7441, Internal Revenue Code of 1954). To this it may be answered that taxpayer may obtain judicial review of the Commissioner's determination through a refund suit and that Congress plainly did not intend that an independent Tax Court review of the imposition of the penalty should be allowed in a situation arising under Sections 291(a) and 6651(a) where the correctness of the tax itself was not in question and had been self-returned.

The decision in *Davis v. Dudley*, 124 F. Supp. 42 (W.D. Pa.), cited by the District Court (R. 16), is not in point here. That case involved additions to tax imposed under Section 294(d) of the 1939 Code, con-

sisting of (1) ad valorem penalties for failure to file timely declarations of estimated tax, (2) ad valorem penalties for failure to pay within the time prescribed installments of declared estimated tax, and (3) ad valorem penalties for substantial underestimates of estimated tax. The court there pointed out that Section 294(d) omitted the statutory language employed in Sections 291 and 293 of the 1939 Code which was construed and contrasted in *United States v. Erie Forge Co.*, *supra*. Moreover, the report of the *Davis* case does not indicate whether the penalties involved were asserted in connection with the Commissioner's determination of a deficiency in tax which was not contested, which would bring it within the rule of *Middleton v. Commissioner*, *supra*. Furthermore, the footnote to the *Davis* opinion (p. 429) quoted by District Court (R. 16-17), in addition to being dictum, reflects a misunderstanding of the provisions of Section 6659 of the 1954 Code.

On the other hand, we submit the instant case is indistinguishable from *United States v. Erie Forge Co.*, *supra*, which the District Court apparently refused to accept. (R. 15-19.) That case properly construes Section 291 of the 1939 Code, and since Section 6659 of the 1954 Code made no change in existing law, its holding applies equally to both taxable years involved in the instant case. There the Court of Appeals pointed out, in line with the foregoing discussion, that the language of Section 271(a) of the 1939 Code defining the term "deficiency" "precludes delinquency penalties assessed under Section 291 for the late filing of returns from being included in the term 'deficiency'" (191 F. 2d, p. 630). The court

then went on to demonstrate that since Section 291(a) provides that the penalty shall be collected "in the same manner" as the tax, the right to a deficiency notice depended upon the "manner" in which the tax is to be collected, stating (191 F. 2d, pp. 630-631):

The "manner" prescribed by the Code for the collection of a self-retained tax is by assessment by the Commissioner certified to the Collector, with due notice to the taxpayer, and collection, either by distraint or by a proceeding in court such as this. By contrast, Section 293, entitled "Additions to the tax in case of deficiency", provides that *deficiency* penalties are to be "assessed, collected, and paid in the same manner as if (they were) * * * deficiency(ies) * * *." The "manner" prescribed for the collection of deficiencies is by statutory notice of the deficiency, after which the taxpayer has ninety days before the deficiency can be assessed in which to petition the Tax Court for a redetermination. Thus, the Code logically provides that where the penalty is measured by a tax deficiency it is subject to the same procedure as the deficiency, for if the deficiency is revised by the Tax Court the penalty will be revised along with it. However, where the penalty is based upon an amount which the taxpayer has admitted to be due, the Code prescribes the simpler method of collection first outlined. The difference in wording between Sections 291 and 293 is certainly not accidental. If Congress had meant to subject delinquency penalties to the deficiency route it would undoubtedly have said so, just as it did in Section 293 in the case of deficiency penalties. But the words "in the same manner * * * as * * * the tax" in Section 291

admit of but one meaning. If self-retained taxes are collected without the issuance of ninety-day letters, it follows *simpliciter* that none are required for delinquency penalties measured thereon.

Newsom v. Commissioner, 22 T.C. 225, affirmed, *per curiam*, 219 F. 2d 444 (C.A. 5th), upon which the District Court relied in the *Davis* case, *supra*, dealt—as did the *Davis* case—with entirely different statutory language from that involved here and in *Erie Forge Co.* Indeed, the Tax Court expressly recognized this ground of distinction from *Erie Forge Co.* in the *Newsom* case, 22 T.C., p. 227. The court below also refers to *Washburn v. Commissioner*, 7 B.T.A. 483. (R. 15.) But in the *Erie Forge Co.* case, 191 F. 2d, p. 631, the Third Circuit challenged the correctness of the Board's holding there, as the Tax Court also noted in the *Newsom* case (p. 227). Moreover, the facts in the *Washburn* case are unclear as well as the ground for decision and, although the *Washburn* opinion was rendered in 1927, it has never been cited for the proposition here under discussion, as the Third Circuit pointed out in *Erie Forge Co.*, *supra*, p. 631.

Not only is the decision of the District Court clearly wrong as a matter of law, but to allow it to stand would seriously hamper the prompt collection of taxes. Delinquency penalties such as here involved have been a part of our internal revenue system since early times,²³ the obvious purpose of such provisions being

²³ See Section 3176 of the Revised Statutes and the Acts from which it was derived.

to facilitate prompt and orderly collection of the revenue. The purpose of the present statute imposing such penalties would be largely defeated, and taxpayer could delay filing returns showing taxes admittedly due with comparative immunity if the Commissioner can be forced to submit to delays incident to the ninety-day letter and deficiency procedures in order to collect delinquency penalties asserted under the circumstances of the case here under review. Where the penalty is based upon an amount of tax which taxpayer has admitted to be due and where such self-returned taxes are collected without the issuance of ninety-day letters, it follows that no such letters are intended to be required for delinquency penalties measured by those taxes.

CONCLUSION

The decision of the District Court is wrong, the judgment of the District Court should be vacated and set aside and judgment directed dismissing the complaint.

Respectfully submitted,

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AUGUST, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 271 [As amended by Sec. 14(a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231]. DEFINITION OF DEFICIENCY.

(a) *In General*.—As used in this chapter in respect of a tax imposed by this chapter, “deficiency” means the amount by which the tax imposed by this chapter exceeds the excess of—

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b) (2), made.

* * * *

(26 U.S.C. 1952 ed., Sec. 271.)

SEC. 272. PROCEDURE IN GENERAL.

(a) (1) *Petition to Tax Court of the United States*.—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday, or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Tax Court of the United States for a redetermination of the

deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 3653(a) the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court. In the case of a joint return filed by husband and wife such notice of deficiency may be a single joint notice, except that if the Commissioner has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, duplicate originals of the joint notice must be sent by registered mail to each spouse at his last known address.

* * * *

(26 U.S.C. 1952 ed., Sec. 272.)

SEC. 291. [As amended by Sec. 172(f), Revenue Act of 1942, c. 619, 56 Stat. 798]. FAILURE TO FILE RETURN.

(a) In case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per

centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612(d)(1).

* * * *

(26 U.S.C. 1952 ed., Sec. 291.)

SEC. 3653. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) *Tax*.—Except as provided in sections 272 (a), 871(a) and 1012(a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

* * * *

(26 U.S.C. 1952 ed., Sec. 3653.)

Internal Revenue Code of 1954:

SEC. 6211. DEFINITION OF A DEFICIENCY.

(a) *In General*.—For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term “deficiency” means the amount by which the tax imposed by subtitles A or B exceeds the excess of—

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a re-

turn was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b) (2), made.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6211.)

SEC. 6212. NOTICE OF DEFICIENCY.

(a) *In General.*—If the Secretary or his delegate determines that there is a deficiency in respect of any tax imposed by subtitles A or B, he is authorized to send notice of such deficiency to the taxpayer by registered mail.

SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

(a) *Time for Filing Petition and Restriction on Assessment.*—Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A or B and no levy or proceeding in court for its collection shall be made, begun, or prosecuted

until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6213.)

SEC. 6651. FAILURE TO FILE TAX RETURN.

(a) *Addition to the Tax.*—In case of failure to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6651.)

SEC. 6659. APPLICABLE RULES.

(a) *Additions Treated as Tax*.—Except as otherwise provided in this title—

(1) The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

(2) Any reference in this title to “tax” imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

(b) *Additions to Tax for Failure to File Return or Pay Tax*.—Any addition under section 6651 or section 6653 to a tax imposed by another subtitle of this title shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax (including the provisions of subchapter B of chapter 63, relating to deficiency procedures for income, estate, and gift taxes).

(26 U.S.C. 1952 ed., Supp. II, Sec. 6659.)

SEC. 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) *Tax*.—Except as provided in sections 6212 (a) and (c), and 6213 (a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 7421.)

Treasury Regulations on Additions to the Tax, Additional Amounts, and Assessable Penalties (1954 Code) :

Section 301.6659-1 *Applicable Rules.*—(a) *Additions treated as tax.*—Except as otherwise provided in the Code, any reference in the Code to “tax” shall be deemed also to be a reference to any addition to the tax, additional amount, or penalty imposed by chapter 68 with respect to such tax. Such additions to the tax, additional amounts, and penalties shall become payable upon notice and demand therefor and shall be assessed, collected, and paid in the same manner as taxes.

(b) *Additions to tax for failure to file return or pay tax.*—Any addition under section 6651 or section 6653 to a tax shall be considered a part of such tax for the purpose of the assessment and collection of such tax. For applicability of deficiency procedures to additions to the tax, see paragraph (c) of this section.

(c) *Deficiency procedures.*—(1) *Additions to the tax for failure to file tax return.*—Subchapter B or chapter 63 (deficiency procedures) applies to the additions to the income, estate, and gift taxes imposed by section 6651 for failure to file a tax return to the same extent that it applies to such taxes. Accordingly, if there is a deficiency (as defined in section 6211) in the tax (apart from the addition to the tax) where a return has not been timely filed, deficiency procedures apply to the addition to the tax under section 6651. If there is no deficiency in the tax where a return has not been timely filed, the addition to the tax under section 6651 may be assessed and collected without deficiency proced-

ures. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A filed his income tax return for the calendar year 1955 on May 15, 1956, not having been granted an extension of time for such filing. His failure to file on time was not due to reasonable cause. The return showed a liability of \$1,000 and it was determined that A is liable under section 6651 for an addition to such tax of \$50 (5 percent a month for 1 month). The provisions of subchapter B of chapter 63 (deficiency procedures) do not apply to the assessment and collection of the addition to the tax since such provisions are not applicable to the tax with respect to which such addition was asserted, there being no statutory deficiency for purposes of section 6211.

Example (2). Assume the same facts as in example (1) and assume further that a deficiency of \$500 in tax and a further \$25 addition to the tax under section 6651 is asserted against A for the calendar year 1955. Thus, the total addition to the tax under section 6651 is \$75. Since the provisions of subchapter B of chapter 63 are applicable to the \$500 deficiency, they likewise apply to the \$25 addition to the tax asserted with respect to such deficiency (but not to the \$50 addition to the tax under example (1)).

(2) *Additions to the tax for negligence or fraud.*—Subchapter B of chapter 63 (deficiency procedures) applies to all additions to the income, estate, and gift taxes imposed by section 6653(a) and (b) for negligence and fraud.

(3) *Additions to tax for failure to pay estimated income taxes.*—(i) *Return filed by taxpayer.*—The addition to the tax for underpay-

ment of estimated income tax imposed by section 6654 (relating to failure by individuals to pay estimated income tax) or section 6655 (relating to failure by corporations to pay estimated income tax) is determined by reference to the tax shown on the return if a return is filed. Therefore, such addition may be assessed and collected without regard to the provisions of subchapter B of chapter 63 (deficiency procedures) if a return is filed since such provisions are not applicable to the assessment of the tax shown on the return. Further, since the additions to the tax imposed by section 6654 or 6655 are determined solely by reference to the amount of tax shown on the return if a return is filed, the assertion of a deficiency with respect to any tax not shown on such return will not make the provisions of subchapter B of chapter 63 (deficiency procedures) apply to the assessment and collection of any additions to the tax under section 6654 or 6655.

(ii) *No return filed by taxpayer.*—If the taxpayer has not filed a return and his entire income tax liability is asserted as a deficiency to which the provisions of subchapter B of chapter 63 apply, such provisions likewise will apply to any addition to such tax imposed by section 6654 or 6655.

**In the United States Court of Appeals
for the Ninth Circuit**

**RALPH C. GRANQUIST, District Director of Internal
Revenue for District of Oregon, APPELLANT**

V.

MARGARET HACKLEMAN, APPELLEE

**On Appeal From The Judgment Of The United States
District Court For The District Of Oregon**

BRIEF FOR THE APPELLEE

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FILED

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**IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

No. 16035

RALPH C. GRANQUIST, District Director of
Internal Revenue for the District of Oregon,
APPELLANT

v.

MARGARET HACKLEMAN, **APPELLEE**

**On Appeal From The Judgment Of The United
States District Court For The District of
Oregon**

BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion of the District Court (R. 11-19), rendered on the Director's motion to dismiss, is reported at 147 F. Supp. 826. The District Court rendered no opinion in granting judgment.

JURISDICTION

This proceeding is based on a complaint and supporting affidavit (R. 3-6) filed in the District Court of Oregon on September 17, 1956, and an amended complaint (R. 8-10) filed on October 15, 1956; the

prayers of which were, in substance, that the District Court permanently enjoin the collection of amounts assessed against the appellee and the Estate of Abe Hackleman, deceased, of which she is executrix, as penalties for the late filing of income tax returns for the years 1953 and 1954, and declare such assessments null and void. Jurisdiction of the District Court apparently was sought to be invoked under Section 6213 of the Internal Revenue Code of 1954 (R. 3, 8) and 28 U.S.C., Section 1346 (referred to as "Section 1346, Title 26. U.S.C.A." (R.8)). The District Director of Internal Revenue, appellant herein, moved to dismiss the action for lack of jurisdiction on the ground that it was an action to enjoin the collection of internal revenue taxes, the maintenance of which is expressly prohibited by Section 7421 (a) of the Internal Revenue Code of 1954. (R. 11.) Under date of January 7, 1957, the District Court entered an opinion on the Director's motion to dismiss (R. 11-9), and on January 14, 1957, entered an order (R. 20-21) denying the motion to dismiss, restraining the collection of the penalties in issue until further order, and allowing the District Director 30 days within which to answer the complaint on the merits or submit to the prayer thereof. The District Director filed an answer to the complaint (R. 21-23) on April 12, 1957, again asserting lack of jurisdiction in the

court below to grant the relief prayed for. Motions for summary judgment were filed by the appellee on Octobed 18, 1957 (R. 24-25), and by the District Director on October 25, 1957 (R. 25-26). A judgment granting appellee the relief prayed for was entered by the District Court on January 13, 1958 (R. 26-28), and notice of appeal was filed by the District Director on February 27, 1958 (R. 28). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether additions to the tax, imposed under Section 291 (a) of the Internal Revenue Code of 1939 and 6651 (a) of the Internal Revenue Code of 1954 for the late filing of income tax returns, may be assessed and collected, without the prior issuance of ninety-day deficiency letters.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Codes of 1939 and 1954 and Treasury Regulations are printed in the Appendix, *infra*.

STATEMENT

Abe Hackleman died April 17, 1953. At the time of his death, he and his now-bereaved widow oper-

ated a 25,000-acre ranch upon which they raised some 1,500 head of cattle. Like most cattle ranchers, he was property poor and operated the ranch on crop loans. Like many cattle ranchers, his income tax records for 1951 through 1953 were in the hands of a revenue agent who was trying to convert Mr. Hackleman's accounting method from a cash to an inventory basis. This matter was finally concluded in the spring of 1956 with a deficiency for all years of some \$400.00, but during the interlude of 1953 to 1956 the revenue agent made demand for and received the income tax records for 1953 and 1954. Ostensibly, this was necessary to give effect to a net operating loss carry-over which arose out of the audit. During the period of the audit it was the understanding of Mr. Hackleman's accountant and the attorneys for the Estate of Abe Hackleman that the tax attorney to whom the government auditor eventually returned the records was to file the return. Mrs. Hackleman and the tax attorney thought that her accountant was to prepare the returns when the federal audit was completed and that the accountant had secured the necessary extensions of time in which to file the income tax returns.

On June 6, 1958, which was shortly after the conclusion of the audit, the appellee filed with the appellant, District Director of Internal Revenue for the District of Oregon, income tax returns for her-

self for 1953 and 1954 and for the Estate of Abe Hackleman for 1953 and 1954, and paid the taxes and interest due thereon. (R. 8, 21.)

On or about June 6, 1956, there were assessed against Abe and Margaret Hackleman, because of a mathematical error in their return for that year, additional income taxes for the year 1953 in the sum of \$180.34, together with interest in the sum of \$28.76, and an addition to the tax for late filing of the return for that year in the sum of \$346.16; and on or about the same date there were assessed against the Estate of Abe Hackleman, because of a mathematical error in the return for that year, additional income taxes for the year 1953 in the sum of \$120.35, together with interest in the sum of \$22.85, and an addition to the tax for late filing of the return in the sum of \$476.31. These assessments for 1953 were not jeopardy assessments, and statutory notices of deficiency required by Section 272 (a) of the Internal Revenue Code of 1939 were not issued prior to the making of the assessments. (R. 8, 9, 22.)

Also, on or about June 6, 1956, there was assessed against Margaret Hackleman for the year 1954 an addition to the tax for that year in the sum of \$578.49, as provided by Section 6651 of the Internal Revenue Code of 1954, for the late filing of her return for that year; and on or about the same date

there was assessed against the Estate of Abe Hackleman for the year 1954 an addition to the tax for that year in the sum of \$663.90, as provided by Section 6651 of the 1954 Code, for the late filing of the return for that year. These assessments for 1954 were not jeopardy assessments, and statutory notices of deficiency required by Section 6212 of the 1954 Code were not issued prior to the making of the assessments. (R. 9, 10, 22.)

The Hackleman ranch is some sixty miles from nowhere in the remote regions of Crook County, Oregon. Mail is received once a week. On the 16th day of September, 1956, Mrs. Hackleman received a notice from the government which demanded that payment of the addition to the tax for the failure to file a timely return be made that day. At the time of receiving this demand for payment, Mrs. Hackleman did not have sufficient funds to meet the demand and was in the process of rounding up the cattle and harvesting the hay before the threatening winter snow set in. She managed to contact her attorney, Mr. Hickok, by phone and inform him of the demand and her inability to meet it. Mr. Hickok promptly took the matter up with Mr. Calvin Palmer, the local collection officer to whom the account had been assigned. Mr. Hickok explained the circumstance of the late filing and requested that the matter be referred for an administrative

determination of whether or not the failure to file timely income tax returns was due to reasonable cause and not due to wilful neglect. Mr. Palmer refused to do so and asserted that he was going to seize the ranch and bank account that day unless the tax was paid. Mr. Hickok explained that this would result in considerable hardship to appellee, due to loss of cattle and hay in the inclement weather. Mr. Palmer agreed to give Mr. Hickok 24 hours to drive the 162 miles to Portland and secure a directive from Mr. Sims, Chief of the Collection Division, referring the matter for an administrative determination.

Mr. Hickok went to Portland and explained the problem to Mr. Sims and requested the matter be referred for administrative determination. Mr. Sims admitted there was a question of whether or not the failure to file timely tax returns was due to reasonable grounds and not due to wilful neglect; but in spite of the loss Mrs. Hackleman would incur by a seizure of the ranch and in spite of the lack of funds to pay the additions to the tax which might not be owing, he refused to refer the matter for administrative review on the grounds that the payment of the addition to the tax and the suit for refund constitute sufficient administrative remedy, even though the pursuit of such a remedy is contrary to the purpose for which the Tax Court was

created and causes the taxpayer irreparable harm.

The present suit is to enjoin collection of the above amounts assessed as additions to the tax for late filing of returns without reasonable cause and due to wilful neglect, and to invalidate the assessments for these additions to the tax, on the ground that statutory deficiency notices were not issued prior to the making of the assessments. The District Court entered summary judgment granting the relief prayed for (R. 26-28), and the Director appealed (R. 28).

STATEMENT OF POINT TO BE URGED

The District Court was correct in concluding that the assessment of an addition to the tax under Section 291 (a) of the Internal Revenue Code of 1939 and under Section 6651 (a) of the Internal Revenue Code of 1954 is subject to the restrictions upon assessment of deficiencies in income tax provided by Section 272 (a) of the Internal Revenue Code of 1939 and Section 6213 of the Internal Revenue Code of 1954.

SUMMARY OF ARGUMENT

This is a suit to enjoin the collection of additions to the income tax of the appellee for the failure, without reasonable cause and due to wilful neglect, to file timely income tax returns.

The assessment of a penalty may be enjoined, but the assessment of an income tax may not be enjoined unless

(1) There exist extreme equitable grounds for such injunction, ⁽¹⁾ or

(2) The statutory restrictions on the assessment of income, estate, and gift taxes have not been complied with. ⁽²⁾

The suit herein was brought by the plaintiff below to enjoin the assessment of a tax ⁽³⁾ and not to enjoin the assessment of a penalty. Although there may exist sufficient equitable grounds to enjoin the assessment of tax in spite of the prohibitions contained in Section 7421 (a), the plaintiff did not rely upon these equitable grounds but sought a mandatory injunction under Section 6213 for the failure to comply with the restrictions on the assessment deficiencies in income tax.

It is submitted that if these additions to the tax were penalties, the prohibition on restraint from the assessment and collection of taxes would not be applicable.

The Board of Tax Appeals, now the Tax Court, was created as a forum where taxpayers may litigate

⁽¹⁾ *Miller v. Standard Nut Margarine Co.*, 284 U.S. 498

⁽²⁾ *Davis v. Dudley*, 124 F. Supp. 426

⁽³⁾ *Myers v. Commissioner*, 28 T.C. —, No. 2, filed April 19, 1957; *Washburn v. Commissioner*, 7 B.T.A. 483; I.R.C. 1954, Sec. 6659 (a) (2)

their liability for additional income, estate, or gift taxes before being required to pay. In the creation of the Board of Tax Appeals, Congress had the following to say:

“The right of appeal after payment of a tax was an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment. The payment of a large additional tax on income received several years previous which may have, since its receipt, been either wiped out by subsequent losses, invested in nonliquid assets, or spent, sometimes forces taxpayers into bankruptcy, and often causes great financial hardship and sacrifice. These results are not remedied by permitting the taxpayer to sue for the returning of the tax after payment. He is entitled to an appeal and to determination of his liability prior to its payment.” Ways and Means Committee of the 68th Congress, First Session, House of Representatives Report No. 179, Pages 7 and 8.

When the appellee filed her income tax returns on June 6, 1956, and paid the amount of the income tax shown to be due thereon, she admitted only that it appeared to her that she owed that amount of income taxes shown on her return; she did not admit that she owed any other type of tax or an additional amount of income tax. When the commissioner assessed an additional amount of income tax as an addition to the tax for the failure, without reasonable cause and due to wilful neglect, to file timely income tax returns, he was assessing an additional

amount of income taxes, which additional amount of tax, when added to the amount of income tax shown upon the return, constituted the correct tax; and excess of this correct tax over the amount of tax shown on the return is a deficiency. The assessment and collection of a deficiency so determined may not be made until the taxpayer has had an opportunity to have the matter determined by the Tax Court.

It is admitted that the conflict between the **Erie Forge** case ⁽⁴⁾ (wherein the government was otherwise barred by the statute of limitations) and the **Washburn** case (*supra*) created confusion under the 1939 Code prior to the clear Congressional pronouncement in the 1954 Code. ⁽⁵⁾ It is submitted that the commissioner tried to dissuade Congress from making such additions to the tax subject to the procedure for the assessment and collection of a deficiency but was unsuccessful as was inferred in the committee reports: ⁽⁶⁾

“Section 6659 also makes clear that the procedures for the assessment of deficiencies in income, estate, and gift taxes (including ninety-day letters and appeal to the Tax Court) also apply to additions to those taxes.”

It was always clear under the 1939 Code that

⁽⁴⁾ *United States v. Erie Forge Co.*, 191 F. 2d 627, certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970

⁽⁵⁾ I.R.C. 1954, Sec. 6659 (a) (2)

⁽⁶⁾ H Rep. No. 1337, 83rd Cong. 2d Sess., p. A420 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4568)

where the commissioner assessed a deficiency in tax irrespective of the existence of an addition to the tax for the failure to file a timely return and also assessed an addition to the tax, the entire deficiency so determined was subject to the procedure for assessment of the deficiency. As was inferred by the committee reports, it was not clear that a deficiency in income, estate, and gift taxes arising only from the assessment of an addition to the tax for the failure to file a timely return was subject to procedure for the assessment of a deficiency. As the committee reports state in the above quotation, the 1954 Code clarified this ambiguity.

Furthermore, since the advent of the 1954 Code, the Tax Court, ⁽⁷⁾ the Court of Appeals for the Fifth Circuit, ⁽⁸⁾ and four United States District Courts ⁽⁹⁾ (being all the courts that have considered this matter) have all uniformly held that these additions to the tax are subject to the procedure for the assessment and collection of deficiencies.

The rationale behind these decisions has not only

⁽⁷⁾ *Newsom v. Commissioner*, 22 T. C. 225
Myers v. Commissioner 28 T.C. —, No. 2, filed April 9, 1957

Marbut v. Commissioner 28 T.C. —, No. 74, filed June 24, 1957

⁽⁸⁾ *Newsom v. Commissioner*, 22 T.C. 225, affirmed CA-5 219 F. 2d 444

⁽⁹⁾ *Davis v. Dudley*, 124 F. Supp. 426 (West Dist. Pa.); *McAllister v. Dudley*, 148 F. Supp. 548 (West Dist. Pa.); *Hackleman v. Granquist*, 147 F. Supp. 826 (Dist. Oreg.); *Muse v. Enochs*, 58-2 USTC 9819, decided 8/26/58 (Miss.)

been a literal construction of Section 6659 (b), but also the reasoning that inherent to the success of our system of taxation by self-assessment is the requirement that the taxpayer be afforded an opportunity of judicial review before paying any additional amounts. Thus our citizens, rich and poor alike, are protected from the arbitrary and capricious administration of our tax laws. Taxation without due process of law is as tyrannical as taxation without representation, which oppression led our forefathers to found this country.

ARGUMENT

Additions To Income, Estate, Or Gift Taxes Imposed Under Sections 291 (a) Of The Internal Revenue Code of 1939 And 6651 (a) Of The Internal Revenue Code Of 1954 For The Late Filing Of An Income, Estate, Or Gift Tax Return Without Reasonable Cause For Such Neglect And Due To Wilful Neglect Are Subject To The Procedure For The Assessment Of Deficiencies In Income, Estate, And Gift Taxes (Including Ninety-Day Letters And Appeal To The Tax Court.)

This is a suit to enjoin the collection of additions to the income tax of the appellee for the failure, without reasonable cause and due to wilful neglect, to file timely income tax return.

The assessment of a penalty may be enjoined, but the assessment of an income tax may not be

enjoined unless:

(1) There exist extreme equitable grounds for such injunction, ⁽¹⁰⁾ or

(2) The statutory restrictions on the assessment of income, estate, and gift taxes have not been complied with. ⁽¹¹⁾

The suit herein was brought by the plaintiff below to enjoin the assessment of a tax and not to enjoin the assessment of a penalty. Although there may exist sufficient equitable grounds to enjoin the assessment of tax in spite of the prohibitions contained in Section 7421 (a), the plaintiff did not rely upon these equitable grounds but sought a mandatory injunction under Section 6213 for the failure to comply with the restrictions on the assessment of a deficiency in income tax.

An addition to income, estate, and gift taxes under Section 6651 for the failure, without reasonable cause and due to wilful neglect, to file a timely income, estate, or gift tax return is specifically made part of the correct tax by Section 6659 (b) which states:

"Section 6659 Applicable Rules. —(a) Additions treated as tax.—Except as otherwise provided in this title—

(1) The additions to the tax, additional

⁽¹⁰⁾ *Miller v. Standard Nut Margarine Co.*, 284 U.S. 498

⁽¹¹⁾ *Davis v. Dudley*, 124 F. Supp. 426

amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

“(2) Any reference in this title to ‘tax’ imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

“(b) **Additions to tax for failure to file return or pay tax.**—Any addition under Section 6651 or Section 6653 to a tax imposed by another subtitle of this title shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax (including the provisions of Subchapter B of Chapter 63, relating to deficiency procedures for income, estate, and gift taxes).”

The Court should note that this section is divided into two parts, Paragraph (a) which makes **all additions** to the tax part of the tax to which the addition applies, and Paragraph (b) which makes the addition to the tax for the failure to file a timely income, estate, or gift tax return subject to the restrictions on assessments, including a ninety-day letter. It is only in the case of income, estate, and gift taxes that the manner of assessment and collection of additional taxes require the issuance of a ninety-day letter. ⁽¹²⁾

Although it is the opinion of the Court below

⁽¹²⁾ *Muse v. Enochs*, 58-2 USTC 9819, decided 8/26/58 (Miss.)

that an addition to income tax for the failure, without reasonable cause and due to wilful neglect, to file a timely return is a deficiency within the meaning of Section 6211, such a determination is not essential to the validity of the Court's decision for the reason that Section 6659 (b) specifically makes the assessment of such additions in the case of income, estate, and gift taxes subject to the issuance of a ninety-day letter and the taxpayer's right to appeal to the Tax Court, rather than pay an additional tax he does not owe with money he does not have and then sue for refund in the United States District Court or Court of Claims.

The conclusion that additions to income, estate, and gift taxes are a deficiency is predicated upon two sections of the Internal Revenue Code. Section 6659 (a) (2) provides that

“Any reference in this title to ‘tax’ imposed by this title shall be deemed also to refer to the addition to the tax”

Section 6211 (a) in general defines a deficiency in income tax “. . . the amount by which the ‘tax imposed’” exceeds the amount reported by the taxpayer. This section when read in conjunction with Section 6659 (a) (2) defines the “tax imposed” as the tax imposed under Section 3 plus the additions to

the tax, imposed under Section 6651. ⁽¹³⁾ The excess of this correct amount of "tax imposed" over the tax reported by the taxpayer on his return is a deficiency, ⁽¹⁴⁾ and is subject to the restrictions on the assessment and collection of a deficiency including a ninety-day letter and the opportunity to appeal to the Tax Court.

Although the appellant has provided the Court with an imposing list of citations there are only eight cases relevant to the disposal of this matter, ⁽¹⁵⁾ four of which cases the appellant has not cited. ⁽¹⁶⁾

The first case on this point was the **Washburn** case, 7 B.T.A. 483, where the Board of Tax Appeals held that an addition to the tax for the failure, without reasonable cause and due to wilful neglect, to file timely tax returns was to be assessed as a deficiency in tax. The Board said —

"The penalty for delinquency is assessed,

⁽¹³⁾ *Myers v. Commissioner*, 28 T.C. —, No. 2 filed April 9, 1957.

Marbut v. Commissioner, 28 T.C. —, No. 74, filed June 24, 1957

⁽¹⁴⁾ *Myers v. Commissioner*, 28 T.C. —, No. 2, filed April 9, 1957

Marbut v. Commissioner, 28 T.C. —, No. 74, filed June 24, 1957. Both of these cases dealt with additions to the tax for the failure to file timely estimate tax return, and arose under Section 294 (d) of the 1939 Code. The Court's reasoning would be equally applicable to Section 291 as both sections are in Chapter 1 of the 1939 Code. Both cases are applicable to the 1954 Code wherein Section 291 and Section 294 (d) were combined without substantive change in Section 6651 which is the section herein involved.

collected, and paid in the same manner as, and is a part of, the tax; and therefore, when asserted, is assessed as a deficiency in tax.”

The next case to decide this question was **United States v. Erie Forge Co.**, 191 F. 2d 627, which dealt with some hard facts and made bad law. In that case the taxpayer had failed to file Excess Profit tax reports for the period 1935 to 1940. The returns for the entire period were filed in 1941. On August 30, 1941, the commissioner assessed an addition to the tax for the failure to file timely returns. In 1943

⁽¹⁵⁾ *Washburn v. Commissioner*, 7 B.T.A. 483; *United States v. Erie Forge Co.*, 191 F. 2d 627, certiorari, denied, 343 U.S. 930, rehearing denied, 343, U.S. 970; *Newsom v. Commissioner*, 22 T.C. 225 affirmed, per curiam, 219 F. 2d 444.

Davis v. Dudley, 124 F. Supp. 426; *Myers v. Commissioner*, 28 T.C. —, No. 2, filed April 9, 1957; *Marbut v. Commissioner*, 28 T.C. —, No. 74, filed June 24, 1957; *McAllister v. Dudley*, 148 F. Supp. 548 (West Dist. Pa.); *Muse v. Enochs*, 58-2 USTC 9819, decided 8/26/ (Miss.)

The appellant also cited *Standard Oil Co. v. McMahon*, 244 F. 2d 11, which case is not applicable to the problem as it dealt with interest which is specifically made not subject to deficiency procedures by Section 6601 (f) (1). Section 6659 is not applicable to interest as Section 6659 applies only to Chapter 68; and the interest provision, Section 6601, is in Chapter 67. The Court is asked to compare the language of Section 6601 (f) (1) where Congress did *not* want the deficiency procedure to be applicable to what was basically a mathematical addition to the tax, and Section 6651 (b) where Congress did want the deficiency procedure to be applicable to an addition to the tax involving human discretion.

⁽¹⁶⁾ *Myers v. Commissioner*, 28 T.C. —, No. 2, filed April 9, 1957; *Marbut v. Commissioner*, 28 T.C. — No. 74, filed June 24, 1957; *McAllister v. Dudley*, 148 F. Supp. 548 (West Dist. Pa.); *Muse v. Enochs*, 58-2 USTC 9819, decided 8//2658 (Miss.).

the commissioner gave a statutory notice of deficiency in the amount of \$69,613.60 and added an addition to the tax for the failure to file a timely return in the amount of \$17,245.22. No mention was made of the original additional assessment of 1941 in the amount of \$68,517.63. Six months after the testimony was closed the commissioner sought to amend his pleadings to include the 1941 assessment. The Tax Court refused and the commissioner appealed to the Court of Appeals for the Third Circuit which sustained the Tax Court. In 1947 the commissioner again attempted the collection of the 1941 additions to the tax without a statutory notice of deficiency. The issuance of a statutory notice of deficiency was then barred by the statute of limitations.

The Court of Appeals concluded that this addition to the taxes was not subject to the deficiency procedure. The Court held that the language, "collected in the same manner as the tax," meant the tax shown on the return.

The Court argued—

“However, where the penalty is based upon an amount which the taxpayer here admitted to be due, the Code prescribes the simpler method of collection first outlined.”

It is submitted that Court erred in so holding in that the language, “same manner as the tax,” does not refer to the tax shown on the return but refers

to the type of tax. ⁽¹⁷⁾ When the taxpayer filed a tax return and paid the tax shown to be due thereon it did not also admit that it owed an additional tax for the failure, without reasonable cause and due to wilful neglect, to file a timely return. To the contrary, the remission of the tax shown to be due on the return without the addition to the tax for the failure to file a timely return was an express denial that such failure was without reasonable cause and was due to wilful neglect.

The next case on this point was *E. C. Newsom*, 22 T.C. 225 (CA-5) 219 F. (2d) 444, which dealt with an addition to the tax under Section 294 (d) (2) of the 1939 Code for substantial underestimate of tax. In that case the commissioner had issued a statutory notice of deficiency for the sole purpose of assessing an addition to the tax for the substantial underestimate of tax. These additions to the tax the Tax Court held to be a deficiency and cited its former decision in the *Washburn* case. The affirming opinion of the Court of Appeals is quite brief and should be noted:

“Before HUTCHESON, Chief Judge, and RIVES and TUTTLE, Circuit Judges.

“PER CURIAM: The decision is affirmed on the opinion of the Tax Court, 22 T.C. No. 31 (CCH Dec. 20, 315), followed in *Davis v.*

⁽¹⁷⁾ *McAllister v. Dudley*, 148 F. Supp. 548 (West Dist. Pa.).

Dudley, Dist. Ct. W. D. Pa., 124 Fed. Supp. 426, 429 (54-2 USTC 9590), by District Judge MARSH, one of the judges who had joined in deciding **United States v. Erie Forge Co.**, 3rd Cir., 191 Fed. (2d) 627 (51-2 USTC 9461), thought by the petitioner to be in conflict with the decision of the Tax Court. Affirmed."

In **Davis v. Dudley**, 124 F. Supp. 426, the commissioner had assessed the same penalty (Section 294 (d)) as was involved in the **Newsom** case but this time did not issue a statutory notice of deficiency as he did in the **Newsom** case. Judge Marsh, who wrote the opinion and who was one of the judges participating in the **Erie Forge Co.** decision, held that such additions to the tax for the failure, without reasonable cause and due to wilful neglect, to file an estimate income tax return were deficiencies and subject to deficiency procedures.

Where the additions are to the same tax for the same reason; namely, the failure, without reasonable cause and due to wilful neglect, to file timely returns, is it conceivable that Congress intended that the taxpayer should have no administrative remedies where that addition is to the tax shown on the final tax return but should have administrative remedies where the addition is to the same tax but is shown on the estimated tax return?

It is interesting to note that the appellant in his brief (p. 26) states that Judge Marsh, who partici-

pated in the **Erie Forge Co.** opinion did not, in deciding the **Davis** case understand the language of Section 291 when it was carried over into the 1954 Code in Section 6659. After the clairfying language of the 1954 Code the judge who participated in the opinion in the **Erie Forge Co.** case was prompted to write—

“In this connection it is interesting to note that in the Internal Revenue Code of 1954, in two sections (6651 and 6653) where the imposition of penalties likewise depends upon the exercise of judgment, collection thereof is by way of deficiency procedure and not in the manner of collecting taxes: see Section 6659.”

The next court to determine this question, other than the court below in the instant case, was the United States District Court for the District of Pennsylvania in the case of **McAllister v. Dudley**, 148 Fed. Supp. 546, decided December 27, 1956, 57-1 USTC 9302. The suit involved an injunction brought to restrain the assessment of penalties for the failure to pay over withholding taxes. There the Court noted—

“Section 2707 (a) of the Internal Revenue Code of 1939 and Section 6671 of the Internal Revenue Code of 1954 are substantially similar in that each provides that the penalty shall be assessed and collected in the same manner as taxes. From that we conclude that the penalty imposed for the wilful failure to pay employment taxes shall be assessed and collected in

the same manner as employment taxes would be assessed and collected

“The assessment here involved not being an assessment of a deficiency in respect of any income, estate, or gift tax, the suit to enjoin the collections thereof falls within the prohibitions contained in Section 7421 (a) of the Internal Revenue Code of 1954 and the actions must be dismissed.”

The next case to consider this question was **Myers v. Commissioner**, 28 T.C. —, No. 2 filed April 9, 1957. In that case the commissioner had for the years 1949 and 1950 assessed additions to the tax for the failure to file timely estimates of income tax and for the substantial underestimate of estimated income tax. The commissioner had also found over-assessments for each year. For the year 1949 the additions to the tax exceeded the overassessment and there was a net deficiency. For the year 1950 the overassessments exceeded the additions to the tax and there was a net overassessment. The Court, in holding it had jurisdiction as to 1949 because there was a deficiency and did not have jurisdiction as to 1950, said—

“The real question for each year is whether the additions to the tax under Section 294 (d) are to be considered a part of the tax for the purpose of Section 271 (a), which defines a deficiency, for present purposes, as the amount by which the tax imposed by Chapter 1 exceeds the amount shown as the tax by the taxpayers upon their return. Here no rebate is involved,

and the amount shown as an overassessment for each year is the difference between the tax imposed by Subchapter B of Chapter 1 and the amount shown as the tax by the taxpayers upon their return. Section 294, a part of Supplement M of Chapter 1, is entitled 'Additions to the Tax in Case of Nonpayment,' and the provisions of (d) are that certain amounts 'shall be added to the tax.' Those additions are a part of the whole tax imposed by Chapter 1 and must be considered along with the so-called overassessment of the Subchapter B tax for that year to find out whether the commissioner actually determined a deficiency for the year within the definition of Section 271 or whether he determined an overassessment. *E. C. Newsom*, 22 T.C. 225 (Dec. 20, 315), *aff'd. per curiam* 219 Fed. (2d) 444 (55-1 USTC 9253); *Union Telephone Company*, 41 B.T.A. 152 (Dec. 10, 969); *Ely & Walker Dry Goods Co. v. United States*, 34 Fed. (2d) 429 (1 USTC 423), *cert. denied* 281 U.S. 755; *Schneider v. United States*, 119 Fed (2d) 215 (41-1 USTC 9389); *Herbert Eck*, 16 T.C. 511 (Dec. 18, 146), *aff'd. per curiam* 202 Fed. (2d) 750 (53-1 USTC 9287), *cert. denied* 346 U. S. 822.

" 'The tax imposed by this chapter,' Chapter 1, is here the sum of that portion of the tax imposed by Subchapter B and the additions thereto imposed under Section 294 (d) of Supplement M, both of which provisions are a part of Chapter 1. The tax thus imposed under Chapter 1 for the year 1949, in the opinion of the commissioner, exceeds the tax shown as the tax by the taxpayers upon their return; a deficiency would result under the definition of Section 271; the statutory notice sent by the commissioner shows that he has determined a deficiency in the net amount of \$106.05; and

the Tax Court thus has jurisdiction over the entire income tax liability of the petitioners for that year.”

The next case to consider this question was **Marbut v. Commissioner**, 28 T.C. —, No. 74, filed June 24, 1957. In this case the taxpayer had consented to an extension of the statute of limitations on the assessment and collection of tax. After the expiration of the statute of limitations but within the period prescribed by the extension agreement, the commissioner sent a statutory notice asserting a deficiency arising only out of additions to the tax for the failure to file timely estimated tax returns and substantial underestimate of tax. In holding that these additions to the tax were a deficiency the Court said—

“It is well established that the word ‘tax’ includes any applicable interest, penalty, or other addition, all of which are to be assessed and collected in the same manner as in the case of the principal amount of tax. **Helvering v. Mitches**, 303 U. S. 391 (1938) (38-1 USTC 9152); **Schneider v. United States**, (C. A. 6, 1941) 119 Fed. (2d) 215 (41-1 USTC 9389); **E. C. Newsom**, 22 T.C. 225 (Dec. 20, 315), affirmed per curiam (C. A. 5, 1955) 219 Fed. (2d) 444 (55-1 USTC 9253); **Charles E. Myers, Sr.**, 28 T.C.—, No. 2 (Apr. 9, 1957) (Dec. 22, 323). The **Newsom** and **Myers** cases point out that Section 271 (a) defines a deficiency in terms of ‘the tax imposed by this chapter,’ Chapter 1. Section 294 is included in ‘this chapter.’ It follows, therefore, if a section 294 addition to the tax can by itself be a deficiency within the

meaning of Section 271 (a), it is a part of the tax for the purpose of assessment and collection.”

The last court to consider this question was the United States District Court for the Southern District of Mississippi in the case of **Muse v. Enochs**.—Fed. 2d—58-2 USTC 9819 decided August 26, 1958. In that case the taxpayers filed their income tax return for the year 1956 and paid the tax therein. The commissioner, without a statutory notice, assessed an addition to the tax under Section 6654 for the substantial underestimate of estimated income tax. In sustaining the taxpayer the Court said—

“It is quite clear that the plaintiffs must prevail. Section 6659 of the Internal Revenue Code of 1954 specifically states that all of the additions to tax, additional amounts and penalties provided by Chapter 68 of the Internal Revenue Code of 1954 shall be assessed, collected and paid in the same manner as taxes and that any reference in the Internal Revenue Code to ‘tax’ imposed shall be deemed also to refer to the additions to the tax, additional amounts and penalties provided by Chapter 68. Section 6654 is a part of Chapter 68 of the Internal Revenue Code of 1954.

“Furthermore, in the Senate Committee Report to be found at page 4568, 1954 U. S. Code and Congressional Administrative News, the following reference is made to Section 6659:

““This section is identical with that of the House Bill.

““This section provides that the additions to the tax, additional amounts, and penalties

provided by Chapter 68 shall be assessed, collected, and paid in the same manner as taxes, except where otherwise specifically provided in another section of this title. This conforms to the rules under existing law. By virtue of this section, it is unnecessary in other parts of the title to specifically refer to these additions to the tax when providing rules as to the collection, assessment, etc., of the taxes. This section also makes clear that the procedures for the assessment of deficiencies in income, estate and gift taxes (including 90-day letters and appeal to the Tax Court), also apply in additions to those taxes.'

"Such statutory language is too clear for discussion. The contention of the defendant that the determinations of penalties or additions to tax for underestimation or underpayment of estimated tax are mere 'mathematical errors', appearing upon the return, so that under the provisions of Section 6213 (b) the defendant is relieved from the restrictions on assessment of tax contained in Section 6213 (a), is wholly untenable.

"See the cases of **Hackleman v. Granquist**, 147 Fed. Supp. 826 (DC, Ore., 1957) (57-1 USTC 9560); **Newsom v. Commissioner**, 22 TC 225 (CCH Dec. 20, 315), aff'd. 219 Fed. (2d) 444 (CA 5th, 1955) (55-1 USTC 9253); and **Davis v. Dudley**, 124 Fed. Supp. 426 (DC Pa., 1954) (54-2 USTC 9590), where the same point was involved, and in all of which cases the taxpayer prevailed."

The position of the appellant and the regulations

of the commissioner ⁽¹⁸⁾ are in clear derogation of Section 6659. With the exception of the **Erie Forge Co.** case, every court that has considered this question has rendered an opinion contrary to the position asserted by the appellant. ⁽¹⁹⁾ The **Erie Forge Co.** case stands by itself. The judge who wrote the opinion later relegated it to oblivion by the process of distinguishment and proclaimed it inapplicable under the 1954 Code. ⁽²⁰⁾

The argument of the appellant has three facets; first, that this is mere mathematical error. This position was asserted in oral argument below and in the **Muse** case which held that such an argument is untenable. It is submitted that the question of

⁽¹⁸⁾ Regulations: Section 301.6659-1 (Appendix, *infra*). The Regulations were published subsequent to the *Hackleman*, *Newsom* and *Davis* cases, but were published prior to the *Myers*, *Marbut* and *Muse* cases. To this extent the latter cases refused to follow the Regulations. Tax practitioners objected to the promulgation of these Regulations in present form. The Committee on Taxation of the Oregon State Bar Association sought to file a formal objection to these Regulations but was unable to do so without submitting the matter to the entire Bar Association for a vote which was not feasible. It is submitted that these Regulations are directly contradictory to Section 6659 and the decided cases.

⁽¹⁹⁾ *Washburn v. Commissioner*, 7 B.T.A. 483; *Newsom v. Commissioner*, 22 T.C. 225 affirmed, per curiam, 219 F. 2d 444; *Davis v. Dudley* 124 F. Supp. 426; *Myers v. Commissioner*, 28 T.C. —. No. 2, filed April 9, 1957; *Marbut v. Commissioner*, 28 T.C. —, No. 74 filed June 24, 1957; *McAllister v. Dudley*, 148 F. Supp. (West Dist. Pa.); *Muse v. Enochs*, 58-2 USTC 9819, decided 8/26/58 (Miss.).

⁽²⁰⁾ *Davis v. Dudley*, 124 F. Supp. 426 (West Dist. Pa.).

whether or not the failure to file a timely return was due to reasonable cause and not due to wilful neglect is not the subject of mathematical formulae.
(21)

Secondly, the appellant contends that the mere late filing of a return is a confession of guilt and is an admission that the failure was without reasonable cause and was due to wilful neglect; ⁽²²⁾ that the amount so admitted shall be collected in the same manner as the amount of tax shown on the return. It is submitted that appellant knew when the return was due and that when she filed a return at a later date she knew it was late. But when she paid only the tax shown to be due thereon she expressly denied any liability for an addition to this tax due to her failure, without reasonable cause and due to wilful neglect, to file a timely return. She was not making a self return of such addition to the tax. It is further submitted that the language of Section 291, "same manner as the tax," does not refer to the amount of tax shown on the return but refers to the type of tax to which the addition applies as was held in the *McAllister* case (*supra*). The

(21) Compare Section 6601 (f) (1) dealing with deficiency procedure in the case of interest which is purely mathematical and Section 6659 (b), dealing with additions to the tax involving human discretion.

(22) The appellant and the *Erie Forge* case argue that the addition to the tax is admitted as well as the amount of the tax shown on the return

manner of collecting additional income taxes is by deficiency procedure and not by arbitrary assessment. ⁽²³⁾

Thirdly, the appellant contends that the application of deficiency procedures to the additions to the tax will:

(a) "Seriously hamper the prompt collection of taxes." ⁽²⁴⁾

(b) "The purpose of the present statute imposing penalties would be largely defeated, and taxpayer would delay filing returns showing taxes admittedly due with comparative immunity if the commissioner can be forced to submit to delays incident to the ninety-day letters and deficiency procedures in order to collect delinquency penalties under the circumstances of the case under review."

⁽²⁵⁾

Such an argument is untenable. The great success of our system of taxation by self-assessment was predicted on the premise that the great majority of Americans pay the taxes they think are owing. If the taxpayer thinks he owes the additional tax, the commissioner may ask him, as in the case of other deficiencies, to sign a Form 870 which is a form consenting to the assessment and waiving the restrictions on the assessment and col-

⁽²³⁾ Section 6213 (Appendix, *infra*)

⁽²⁴⁾ Appellant's brief, p. 28

⁽²⁵⁾ Appellant's brief, p. 29

lection of taxes under Section 6213. Congress realized that it is the desire of Americans to pay promptly the tax admittedly due and therefore prescribed a means by which the restrictions upon assessment and collection of a deficiency could be waived.

Futhermore, it is in such circumstances as the case under review where, had the appellant prevailed below, the appellee through the collection of a tax not determined to be owing would have lost several thousand dollars' worth of cattle and hay and ultimately her ranch. Congress in its infinite wisdom provided for a system of determining the correctness of a tax before requiring payment and in so providing said—

“The right of appeal after payment of a tax was an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment. The payment of a large additional tax on income received several years previous which may have, since its receipt, been either wiped out by subsequent losses, invested in nonliquid assets, or spent, sometimes forces taxpayers into bankruptcy, and often causes great financial hardship and sacrifice. These results are not remedied by permitting the taxpayer to sue for the returning of the tax after payment. He is entitled to an appeal and to determination of his liability prior to its payment.” Ways and Means Committee of the 68th Congress, First Session, House of Representatives Report No. 179, pages 7 and 8.

Representative Green of Iowa in a discussion on the floor of the House of Representatives said—

“In the revision of the law a special effort was made to give the taxpayer better opportunity to present his case when he thought the tax was being unjustly leveled against him or being levied in too great an amount. For this purpose a Board of Tax Appeals is created, to be appointed by the President and to hear the cases.” Congressional Record, Vol. 65, page 2429.

Thus Congress sought to prevent the tyranny of arbitrary assessment and the wasting of assets sacrificed to pay a tax not determined to be owing.

CONCLUSION

The decision of the District Court is correct, the judgment of the District Court should be affirmed.

Respectfully submitted,

RICHARD H. M. HICKOK
Attorney for Appellee

APPENDIX

Internal Revenue Code of 1939:

SEC. 271 (As amended by Sec. 14 (a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231).
DEFINITION OF DEFICIENCY.

(a) **In General.** — As used in this chapter in respect of a tax imposed by this chapter, “deficiency” means the amount by which the tax imposed by this chapter exceeds the excess of—

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b) (2), made.

* * * *

(26 U.S.C. 1952 ed., Sec. 271.)

SEC. 272. PROCEDURE IN GENERAL.

(a) (1) **Petition to Tax Court of the United States.**
—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday, or a legal holiday in the District of Columbia as the

ninetieth day), the taxpayer may file a petition with the Tax Court of the United States for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 3653 (a) the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court. In the case of a joint return filed by husband and wife such notice of deficiency may be a single joint notice, except that if the Commissioner has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, duplicate originals of the joint notice must be sent by registered mail to each spouse at his last known address.

* * * *

(26 U.S.C. 1952 ed., Sec. 272.)

SEC. 291. (As amended by Sec. 172) (f), Revenue Act of 1942, c. 619, 56 Stat. 798). FAILURE TO FILE RETURN.

(a) In case of any failure to make and file return

required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612 (d) (1).

(26 U.S.C. 1952 ed., Sec. 291.)

SEC. 3653. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) **Tax.**—Except as provided in sections 272 (a), 871 (a) and 1012 (a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

* * * *

(26 U.S.C. 1952 ed., Sec. 3653.)

Internal Revenue Code of 1954:

SEC. 6211. DEFINITION OF A DEFICIENCY.

(a) **In General.**—For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term “deficiency” means the amount by which the tax imposed by subtitles A or B exceeds the excess of—

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b) (2), made.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6211.)

SEC. 6212. NOTICE OF DEFICIENCY.

(a) **In General.**—If the Secretary or his delegate determines that there is a deficiency in respect of any tax imposed by subtitles A or B, he is authorized to send notice of such deficiency to the taxpayer by registered mail.

SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

(a) **Time for Filing Petition and Restriction on Assessment.**— Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after

the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A or B and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421 (a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6213.)

SEC. 6651. FAILURE TO FILE TAX RETURN.

(a) **Addition to the Tax.**—In case of failure to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes,

and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6651.)

SEC. 6659. APPLICABLE RULES.

(a) **Additions Treated as Tax.**—Except as otherwise provided in this title—

(1) The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

(2) Any reference in this title to “tax” imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

(b) **Additions to Tax for Failure to File Return or Pay Tax.**—Any addition under section 6651 or

section 6653 to a tax imposed by another subtitle of this title shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax (including the provisions of subchapter B of chapter 63, relating to deficiency procedures for income, estate, and gift taxes).

(26 U.S.C. 1952 ed., Supp. II, Sec. 6659.)

SEC. 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) **Tax.**—Except as provided in sections 6212 (a) and (c), and 6213 (a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 7421.)

Treasury Regulations on Additions to the Tax, Additional Amounts, and Assessable Penalties (1954 Code):

Section 301.6659-1 Applicable Rules.—(a) **Additions treated as tax.**—Except as otherwise provided in the Code, any reference in the Code to “tax” shall be deemed also to be a reference to any addition to the tax, additional amount, or penalty imposed by chapter 68 with respect to such tax. Such additions to the tax, additional amounts, and penalties shall become payable upon notice and de-

mand therefor and shall be assessed, collected, and paid in the same manner as taxes.

(b) Additions to tax for failure to file return or pay tax.—Any addition under section 6651 or section 6653 to a tax shall be considered a part of such tax for the purpose of the assessment and collection of such tax. For applicability of deficiency procedures to additions to the tax, see paragraph (c) of this section.

(c) Deficiency procedures.— (1) **Additions to the tax for failure to file tax return.**—Subchapter B or chapter 63 (deficiency procedures) applies to the additions to the income, estate, and gift taxes imposed by section 6651 for failure to file a tax return to the same extent that it applies to such taxes. Accordingly, if there is a deficiency (as defined in section 6211) in the tax (apart from the addition to the tax) where a return has not been timely filed, deficiency procedures apply to the addition to the tax under section 6651. If there is no deficiency in the tax where a return has not been timely filed, the addition to the tax under section 6651 may be assessed and collected without deficiency procedures. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A filed his income tax return for the calendar year 1955 on May 15, 1956, not having

been granted an extension of time for such filing. His failure to file on time was not due to reasonable cause. The return showed a liability of \$1,000 and it was determined that A is liable under section 6651 for an addition to such tax of \$50 (5 percent a month for 1 month). The provisions of subchapter B of chapter 63 (deficiency procedures) do not apply to the assessment and collection of the addition to the tax since such provisions are not applicable to the tax with respect to which such addition was asserted, there being no statutory deficiency for purposes of section 6211.

Example (2). Assume the same facts as in example (1) and assume further that a deficiency of \$500 in tax and a further \$25 addition to the tax under section 6651 is asserted against A for the calendar year 1955. Thus, the total addition to the tax under section 6651 is \$75. Since the provisions of subchapter B of chapter 63 are applicable to the \$500 deficiency, they likewise apply to the \$25 addition to the tax asserted with respect to such deficiency (but not to the \$50 addition to the tax under example (1)).

(2) Additions to the tax for negligence or fraud.— Subchapter B of chapter 63 (deficiency procedures) applies to all additions to the income, estate, and gift taxes imposed by section 6653 (a) and (b) for negligence and fraud.

(3) **Additions to tax for failure to pay estimated income taxes.—**(i) **Return filed by taxpayer.—**The addition to the tax for underpayment of estimated income tax imposed by section 6654 (relating to failure by individuals to pay estimated income tax) or section 6655 (relating to failure by corporations to pay estimated income tax) is determined by reference to the tax shown on the return if a return is filed. Therefore, such addition may be assessed and collected without regard to the provisions of subchapter B of chapter 63 (deficiency procedures) if a return is filed since such provisions are not applicable to the assessment of the tax shown on the return. Further, since the additions to the tax imposed by section 6654 or 6655 are determined solely by reference to the amount of tax shown on the return if a return is filed, the assertion of a deficiency with respect to any tax not shown on such return will not make the provisions of subchapter B of chapter 63 (deficiency procedures) apply to the assessment and collection of any additions to the tax under section 6654 or 6655.

(ii) **No return filed by taxpayer.—**If the taxpayer has not filed a return and his entire income tax liability is asserted as a deficiency to which the provisions of subchapter B of chapter 63 apply, such provisions likewise will apply to any addition to such tax imposed by section 6654 or 6655.

In the United States Court of Appeals
for the Ninth Circuit

RALPH C. GRANQUIST, District Director of Internal
Revenue for the District of Oregon, APPELLANT

v.

MARGARET HACKLEMAN, APPELLEE

On Appeal from the Judgment of the United States
District Court for the District of Oregon

REPLY BRIEF FOR THE APPELLANT

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 16035

RALPH C. GRANQUIST, District Director of Internal
Revenue for the District of Oregon, APPELLANT

v.

MARGARET HACKLEMAN, APPELLEE

On Appeal from the Judgment of the United States
District Court for the District of Oregon

REPLY BRIEF FOR THE APPELLANT

The brief heretofore submitted on behalf of the appellant anticipated generally the argument of the appellee in support of the District Court's judgment in this case. However, it is believed that some further discussion of the matter in the light of the brief filed on behalf of the appellee may be helpful to the Court in resolving the problem involved.

1. In the first place, it is to be noted that appellee's statement of the case (Br. 3-8) is an ex parte recitation of facts not shown by the record. The issue presented by this appeal is whether delinquency penalties imposed under Sections 291(a) of the 1939 Code

and 6651(a) of the 1954 Code for the late filing of income tax returns may be assessed and collected, as are the self-retained taxes reported on such returns, without the prior issuance of statutory deficiency notices.

Such delinquency penalties are imposed by those provisions "unless it is shown that such failure [to file within the time prescribed by law] is due to reasonable cause and not due to willful neglect," and appellee's ex parte statement of facts, whether true or not, appears to be an effort to demonstrate that appellee's failure to file timely returns for the years here involved was due to excusable neglect. However, this is not a proper proceeding for determination of the appellee's liability for the delinquency penalties, since the appellee has an adequate remedy at law by suit for refund for determination of this issue, and no such determination was requested by her complaint (R. 3-6) or amended complaint (R. 8-10). Accordingly, such ex parte statements may not be considered in determining the narrow issue presented by this appeal.

Moreover, we find it difficult to reconcile some of the ex parte statements with allegations in the complaints. For instance, it is alleged in the original complaint (R. 3-4) that on or about June 6, 1956, the defendant assessed an addition to tax of approximately \$2,000 under Section 6651 of the 1954 Code, and demanded payment thereof within ten days (no demand being alleged in the amended complaint), while appellee's statement (Br. 6) tends to give the impression that the appellee first learned of the assess-

ment on September 16, 1956, when she "received a notice from the government which demanded that payment of the addition to the tax for the failure to file a timely return be made that day." The original complaint herein was filed September 17, 1956 (R. 6), yet the statement (Br. 6-8) pictures counsel for the appellee as making a feverish and exhaustive effort to obtain administrative review of the penalty assessments between the time such notice was received and the time the complaint was filed as a last resort to protect the rights of the appellee.

2. With respect to the issue here involved, it is first asserted (Br. 9) that the suit herein was brought by appellee "to enjoin the assessment of a tax and not to enjoin the assessment of a penalty." The semantics of the term "tax" is not helpful here. The amounts imposed by the statutory provisions here involved, and by other similar provisions, are not imposed as "taxes", but are imposed as civil sanctions, or ad valorem penalties, for failure to comply with certain specific requirements of the taxing statutes. See *Spies v. United States*, 317 U.S. 492, 495-497. They are so recognized by the taxing statutes themselves, and the assessment and collection provisions here involved, as well as the prohibitions against assessment and collection, and other provisions relating to similar statutory requirements, have sought to assimilate such civil sanctions, or ad valorem penalties, to the taxes with respect to which they are imposed for assessment and collection purposes. The basic fallacy of the appellee's argument is its failure to recognize this fact.

For instance, Section 291(a) of the 1939 Code provides that in the case of any failure to make a timely return, unless it is shown that such failure was due to reasonable cause and not due to willful neglect, "there shall be added to the tax," and the corresponding section (6651(a)) of the 1954 Code provides that "there shall be added to the amount required to be shown a stax on such return," the percentages therein specified. To assimilate these ad valorem penalties to the tax with respect to which they are imposed for assessment and collection purposes, Section 291(a), which applies only to returns of taxes imposed under Chapter 1 of the 1939 Code,¹ provides that the amount "so added to any tax shall be collected at the same time and in the same manner and as a part of the tax", unless the tax has been paid before discovery of the neglect, "in which case the amount so added shall be collected in the same manner as the tax"; while Section 6659 of the 1954 Code, which, as also does Section 6651(a), applies to a wide variety of taxes imposed under the latter Code.² After providing in subsection (a) thereof that the additions to tax, additional amounts, and penalties imposed under Chapter 68 "shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes", and that any reference in the 1954 Code to "tax" imposed by that Code "shall be deemed also to refer to the additions to the tax, additional amounts, and penalties" provided for by Chapter 68, Section 6659 fur-

¹ See appellant's brief, p. 19, fn. 14.

² See appellant's brief, p. 20, fn. 15.

ther provides in subsection (b) with respect to assessment and collection of amounts added to the tax under Section 6651 (relating to delinquent returns, here involved) and Section 6653 (relating to failure to pay tax) "shall be considered a part of such tax for the purpose of applying the provisions of this title relating to the assessment and collection of such tax (including the provisions of subchapter B of chapter 63, relating to deficiency procedures for income, estate, and gift taxes)." ³

Since the appellee's right to injunctive relief in this case depends entirely upon whether the ad valorem penalties assessed against her under Sections 291(a) and 6651(a) for delinquent filing of income tax returns for 1953 and 1954, after taxes reported thereon had been paid, constitute deficiencies within the meaning of Sections 271(a) of the 1939 Code and 6211(a) of the 1954 Code, the essence of appellee's argument, as we see it, seems to be to construe the above provisions of Section 6659 of the 1954 Code as an extension, or qualification, of the statutory definition of "deficiency" to include ad valorem penalties imposed under Section 291(a) of the 1939 Code and Section 6651 of the 1954 Code—but as to the latter, only with respect to income taxes—as "tax imposed by this chapter" in the case of Section 271(a) of the 1939 Code and as "tax imposed by subtitles A or B" in the case of Section 6211 of the 1954 Code.

³ Similar provisions are contained in Section 6671 of the 1954 Code relating to assessable penalties imposed by Subchapter B of Chapter 68, except no reference is made to "deficiency procedures", which obviously would be unavailable in the case of penalties imposed under Subchapter B.

3. We submit there is no basis whatever for any such conclusion so far as the penalties for 1953 are concerned in view of the specific provision of Section 291(a) of the 1939 Code that if the tax has been paid before discovery of the neglect "the amount so added shall be collected in the same manner as the tax", which in this case was payable on notice and demand and could not have been made the basis of an effective deficiency notice. This is the precise issue decided in *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970, and there is no reported authority to the contrary other than the decision below.

With respect to the ad valorem penalties assessed against appellee for 1954 under Section 6651(a), we submit there is no sound basis in the statute or its legislative history for concluding that by the language used in Section 6659 Congress intended ad valorem penalties imposed by Section 6651(a) (with respect to income, estate, and gift taxes) ^{the treated} as "taxes, imposed by subtitles A and B" in the computation of a deficiency under Section 6211 of the 1954 Code. Had it intended any such treatment of the delinquency penalties imposed by Section 6651(a), a part of "Subtitle F—Procedure and Administration," it could more logically done so by drafting Section 6211 to that end. However, that section was based upon Section 271(a) of the 1939 Code and "contains no material changes from existing law". H. Rep. No. 1337, 83d Cong., 2d Sess., p. A405 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4552); S. Rep. No. 1622,

83d Cong., 2d Sess., p. 573 (3 U.S.C. Cong. & Adm. News (1954) 4621, 5222). Moreover, in reporting out the House Bill, the Committee on Ways and Means said of Section 6659 it provides that the additions to the tax, additional amounts, and penalties provided by Chapter 68 "shall be assessed, collected, and paid in the same manner as taxes, except where otherwise specifically provided in another section of this title",⁴ and further, that "This conforms to the rules under existing law".⁵ H. Rep. No. 1337, *supra*, p. A420. The section as reported out by the House Committee was not changed, and the same explanation of the section is contained in the report of the Committee on Finance of the Senate. S. Rep. No. 1622, *supra*, p. 595. This explanation does not indicate an intention that such penalties in the case of income, estate, and gift taxes should be treated as "taxes, imposed by subtitles A and B," within the meaning of Section 6211. Rather, the Committees further explained that "By virtue of this section, it is unnecessary in other parts of the title to specifically refer to these additions to the tax when providing rules as to collection, assessment, etc., of

⁴ There is no other section in the 1954 Code relating to the assessment and collection of delinquency penalties for the late filing of income tax returns.

⁵ The report of the Committee on Ways and Means was submitted March 9, 1954. At that time the only "existing" decision law on the subject was *United States v. Erie Forge Co.*, 191 F. 2d 627 (C.A. 3d), certiorari denied, 343 U.S. 930, rehearing denied, 343 U.S. 970. *Newsom v. Commissioner*, 22 T.C. 225, affirmed, 219 F. 2d 444 (C.A. 5th), and the cases following it, relied upon by the appellee, all were decided later.

tion 59 of the 1939 Code installments of declared estimated tax, and (3) for substantial underestimates of estimated tax. The latter section makes no specific provision for the assessment and collection of penalties imposed thereby, such as those contained in Sections 291 and 293 of the 1939 Code and carried forward, in substance at least, in Section 6659 of the 1954 Code. This failure of Section 294(d) to make separate provision for the assessment and collection of penalties imposed by that section led the court to comment in *Davis v. Dudley, supra*, p. 428, that "The intended manner of collecting the penalties imposed by these subdivisions is thus left somewhat in doubt." Accordingly, based upon the specific language of the section that the penalties shall "be added to the tax", and the Tax Court's conclusion in *Newsom v. Commission, supra*, p. 227, that "it can thus be said to become a part of the tax", it followed the Tax Court in holding that such penalties constituted deficiencies within the meaning of the statute.

Muse v. Enochs (S.D. Miss.), decided August 26, 1958 (2 A.F.T.R. 2d 5617), also cited by appellee (Br. 26-27), which was decided after appellant's brief was written, involves the delinquency penalty imposed by Section 6654 of the 1954 Code (in lieu of sanctions previously imposed by Section 294(d) of the 1939 Code) for failure to pay estimated tax. It adds nothing to what was decided in *Newsom v. Commissioner, supra*, and *Davis v. Dudley, supra*, and like them, whether right or wrong, clearly is not authority for holding that the penalties here involved are "deficiencies" within the statutory definition.

Moreover, it is significant that Section 6654 is not mentioned in subsection (b) of Section 6659, upon which this appellee primarily relies.

While also not directly in point here, this Court's recent decision in *Hansen v. Commissioner*, 258 F. 2d 585, certiorari granted on first issue, November 10, 1958, decided since the appellant's brief in this case was written, as to the penalty issue there involved (pp. 589-591), clearly demonstrates that Congress has dealt separately with delinquency in the filing of declarations of estimated tax, both under the 1939 Code and under the 1954 Code, where the three penalties imposed by Section 294(d) of the former have been consolidated into one penalty imposed by Section 6654 of the 1954 Code. This further demonstrates the inapplicability to the present action of decisions involving delinquency penalties imposed by Section 294(d) of the 1939 Code.

McAllister v. Dudley, 148 F. Supp. 548 (W.D. Pa.), the other case cited for the first time by appellee (Br. 12, 18 fn. 15, 20 fn. 17, 28 fn. 19), clearly is not authority for the proposition that the penalties here involved constitute deficiencies within the meaning of the respective statutes. That was an action to enjoin the collection of a 100% penalty assessed under Section 2707(a) of the 1939 Code for failure to pay income withholding and Federal Insurance Contribution Act taxes. The court there held injunctive relief was prohibited by Section 7421 of the 1954 Code since the penalty was to be assessed and collected in the same manner as taxes. To the extent that it is in any way applicable here, that decision supports the appellant's position in the instant case.









